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Part 2

AIRLINE COMPETITION ENHANCEMENT ACT OF 1989

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

S. 1741

TO AMEND THE FEDERAL AVIATION ACT OF 1958 TO INCREASE COMPETITION AMONG COMMERCIAL AIR CARRIERS AT THE NATION'S MAJOR AIRPORTS, AND FOR OTHER PURPOSES

PART 2

APRIL 5, 1990

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AIRLINE COMPETITION ENHANCEMENT ACT OF 1989

THURSDAY, APRIL 5, 1990

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:45 p.m., in room SR-253, Russell Senate Office Building, Hon. Wendell Ford (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Carol Carmody, professional staff member; Sam Whitehorn, staff counsel; and John Timmons, minority staff counsel.

OPENING STATEMENT BY SENATOR FORD

Senator FORD. Good afternoon, ladies and gentlemen. We had a vote, but I am of the opinion we will not be interrupted for the rest of the afternoon as it relates to votes. At least that is the judgment that is on the Senate floor right now.

This is the second hearing that the Aviation Subcommittee is holding on S. 1741, a bill introduced last October by Senators Danforth and McCain to increase competition in the commercial airline industry.

As I said in the first hearing, a number of the proposals contained in this bill are troubling to me and would, if enacted, create a whole new set of problems. I have already said very publicly that I do not like the proposal for a head tax. I am worried about the proposal to require airlines owning computer reservation systems, so-called CRSs, to divest themselves.

I am bothered by a view of competition that seems to say anyone who gets ahead is doing something wrong or unfair. Where is the incentive to try anything if success brings a penalty?

Despite my objections to many positions in this bill, I think all of us who fly regularly acknowledge that problems with connections, with hub dominance by one carrier and with fares which seem to be higher at hubs. There is enough discontent up here and in other places that the Secretary of Transportation, Mr. Skinner, decided to study the state of competition.

His study, recently released, found competition is healthy in most places, but identified pockets of problems.

We will hear today from Mr. Shane of the Department of Transportation about that study, and I hope we will hear some solutions for a change.

The General Accounting Office, GAO, has testified several times on various aspects of the concentration issue. Today GAO will identify the barriers to entry which block or make it difficult for new entrants into the industry. We will hear testimony, too, from some airlines and airports expressing their views over some of the bill's provisions.

After all this we will have studied the problem almost as much as the Department of Transportation. The only problem with studies, as the Secretary has found out, is that when you finish them people expect you to do something. The Secretary up until now has not chosen to do anything. That, in itself, is a policy, and sometimes I think the best policy may be not to legislate. But the ball is in our court.

I hope that in consultation with my colleagues we will be able to come up with the right solutions, solutions that benefit the flying public and improve the aviation system.

We have now been joined by the distinguished——

Senator McCAIN. Thank you, Mr. Chairman.

Senator FORD. Wait a minute. I have not called your name yet. He has been testifying in another committee and ran over here so he could be on time, and I appreciate that. And Senator McCain has been a very valuable, hard working member of this committee and of the full committee, and I am pleased that he is here and pleased to be working with him. Senator McCain.

OPENING STATEMENT BY SENATOR McCAIN

Senator McCAIN. I thank you, Mr. Chairman for your usual great courtesy and friendship that you have extended to me, and I especially want to express my appreciation to you for holding this hearing because I realize there are elements of this legislation that trouble you, and you could easily not consider this bill at all. Your graciousness in giving us this further opportunity to convince you of the wisdom of our ideas is in keeping with the tradition of the Kentucky gentleman that you are.

I would like to welcome Mr. Shane back before us. We have had many interesting and engaging sessions in the past, and I expect this one to be just as stimulating.

By the way, Mr. Chairman, I was at a hearing concerning an Arizona wilderness bill, the first of its kind and one that is very important to my state that I was testifying on. That is the reason for my tardiness and I apologize.

Mr. Chairman, I believe the Department of Transportation's recently released study on competition in the U.S. domestic airline industry confirms the conclusions of the GAO studies and other governmental studies and industry studies that this subcommittee has reviewed over the past couple of years; that is, market concentration, competition and consumer cost are related.

The question that must be addressed is what can or should be done about it.

Senator Danforth and I have brought to the table a compendium of ideas on what could be done. I am not wedded to the list nor do I believe are any of the co-sponsors. What we are committed to do is finding a way to arrest the concentration occurring in the industry

and increasing competition so that all Americans can enjoy the benefits of deregulation.

I would like to state one final time I do not believe that deregulation was a mistake. I believe it has resulted in many benefits for the consumers. Nor am I opposed to hubs. I support hubs. I believe the hub and spoke system is in large measure responsible for many of the benefits of deregulation. I do not want to see the airline industry reregulated or hubs eliminated.

What we do want to see is the goal of deregulation achieved: adequate, economic, efficient and low priced air transportation. At present I do not view the trends in the industry as pointing towards the fulfillment of that goal. Taking my facts from the DOT study, today we have one less carrier than we did at the advent of deregulation. This, despite a 33 percent increase in air carriers during deregulation's heyday year of 1984.

Today we have five less carriers with 90 percent of the market than we did in 1978, and today's eight carriers are one half the number that constituted 90 percent of the market in 1984.

Finally, while fares have shown a large relative decrease in the ten years since deregulation, close analysis of this decline shows the rate of decline has slowed considerably in the second half of the 1980s and fares actually have increased over the last couple of years. In fact, industry analysts cite three major carriers, Pan Am, TWA and Eastern, as being in serious difficulty. An extension of these trends over the next decade does not reveal to me an air transportation system which is adequate, economic, efficient and low priced.

I am also very concerned about the status of new entrants, whether they are new to the industry or new to a particular route. New entry was supposed to provide competitive pressure resulting in price discipline. If that is not present, we have a serious problem.

There remains only two post-deregulation carriers from the dozens that were formed, and their future is not assured.

As far as route competition is concerned, I quote the DOT study. "There has to be an element of concern about increasing hub concentrating on the one hand and the fact that non-hubbing carriers have stopped competing in most city pairs involving a highly concentrated hub. One competitive factor has been squeezed out, and it is not clear that the weeding out process has yet stabilized."

Given yet another study from a totally different source than previous studies concluding that the industry is becoming more concentrated with negative implications for the consumer, I believe it is time to act. We know what the problems are. We know what options we have to deal with these problems. We are not guaranteed success.

However, I do not believe it serves any good purpose to wait for more failures before we decide to act. At some point today's options will expire, and then we will be left with two choices, a return to rate regulations such as being contemplated in the cable T.V. industry, or an invitation to foreign carriers to enter our domestic markets. We must take control of events before they take control of us.

Thank you very much, Mr. Chairman, for your indulgence.

Senator FORD. Thank you, Senator.

Senator Kasten, do you have a statement you would like to make?

OPENING STATEMENT BY SENATOR KASTEN

Senator KASTEN. Mr. Chairman, thank you very much.

First of all, I am pleased that we are holding this hearing today on S. 1741, the Airline Competition Enhancement Act, and I am even more pleased to welcome as a witness before us on the second panel the President of Midwest Express, Tim Hoeksema. Tim is a hero of America's emerging new economy and more particularly of the deregulated airline industry that allowed Midwest to establish itself and to grow to the dynamic airline that it is today.

He has established an airline that is actually fun to fly. We do not hear much about that. The people are great, the food is superb, and the quality of service is unmatched. It is the kind of an airline that I believe we should be helping.

Senator FORD. They must be stationed in your state.

Senator KASTEN. You wait until you fly to Milwaukee, Mr. Chairman. This is a terrific airline, and that is why I have worked on their behalf to allow them to expand their service into Washington National, LaGuardia and other airports.

They have tried to operate within the slot system, to obtain more slots so that more people could experience what an airline could be. Their attempts to purchase more slots have run into a dead end. This situation, together with similar concerns shared by other Senators, including Senator McCain, resulted in our attaching to the conference report for the fiscal year 1989 appropriations for the Department of Transportation a provision requiring the Department of Transportation to commence a rule making to free up slots for new entrants and also limited incumbents.

That legislation was passed. It passed September 22, 1988.

This legislation required that the Secretary of Transportation commence a rule making within 90 days and come up with a final rule within 270 days, or within nine months. We are now 18 months out, and we have nothing responsive to our concerns from the Department of Transportation.

Six months ago Mr. Shane appeared before the House on September 19th and told us that Secretary Skinner was aware of the shortcoming of the current system and had instructed the staff to get going on this. Still, we have heard nothing.

Now, I do not know where that staff went, I do not know who they are, but nothing has happened, and most of us up here are getting sick and tired of the excuses, the delays, and lack of solutions to this very important problem for limited incumbents and new entrants.

We could introduce another bill calling for another rule making. That is not going to work. I think what we have got to do now is to work on a bill that would change the system. In other words, legislation that would rework the allocation of slots that we would legislate in this committee.

The McCain, Danforth legislation, I think, is important. I am not a co-sponsor of it right now. There are a number of elements of it

which I agree with. But we are going to, I believe, have to rework the allocation of slots through legislation here in this committee. It is the only way that we are going to see the Department of Transportation even begin to move.

Maybe the threat of legislation, or maybe if we would pass it through the subcommittee, the committee and then the full Senate, maybe that somehow will get someone's attention.

But this airline industry question is one that cannot wait. The new entrants have got to have the opportunity to come into these markets, and limited incumbents should be able to expand.

I am going to be working, Mr. Chairman, with you, Senator McCain, Senator Danforth and others, and I look forward to the testimony both of the Department of Transportation witnesses and also Mr. Hoeksema of Midwest Express.

Senator FORD. Thank you, Senator. I am pleased that your fur is up and maybe we can get you to join us in trying to straighten the administration out and your presence on that——

Senator KASTEN. Which administration is that?

Senator FORD. I would not get into that, but I just said the administration. So I am very pleased. We have several other pieces of legislation: if you feel that way about this one, maybe we can get you on those.

Senator KASTEN. I will help you on the airport trust fund.

Senator FORD. Well, wonderful. That is two out of three. I think we will call this hearing off.

I have statements for the record from Senators Hollings and Pressler that I will include at this point.

[The statements follow:]

OPENING STATEMENT BY THE CHAIRMAN

This is the second hearing on S. 1741, the Airline Competition Enhancement Act of 1989, which focuses on several issues critical to the continued competitiveness of the airline industry. Those of us who are responsible for overseeing the industry, and who frequently use the system, have serious concerns, and some of these issues are raised by S. 1741. The bill serves as a means to focus on issues like computer reservations systems (CRS), service to medium and small communities, and barriers to entry to our nation's airports.

Since enactment of the Airline Deregulation Act of 1978, hearing after hearing has focused on anticompetitive conditions within the industry, and how such conditions could be allowed to fester. The new Administration seems to have a more realistic approach to the effects a particular transaction has on competition, and perhaps, if the previous Administration had had a similar enlightened viewpoint, much of the discussion at these hearings might not have been necessary.

We all realize that the industry has become more concentrated, and, while the Department of Transportation's (DOT) study of the airline industry suggests that almost everything is fine, there are many doubters. These doubters include those folks in small and medium-sized communities and carriers trying to provide new service, as well as many of my colleagues.

CRS continues to be a contentious issue. The current DOT regulations are set to expire at the end of the year unless DOT takes action. So far, a broad advance notice of proposed rulemaking has been issued. The Committee and industry anxiously await the completion of the next stage of the rulemaking process and hope that all concerned will have sufficient time to make their arguments before DOT. Clearly S. 1741 presents a different alternative, and one that would "alleviate" the need for rules. But, the real focus of the bill is to make the industry more competitive, and we hope that DOT's efforts achieve that result.

With respect to slots, S. 1741 also seeks to do away with the buy-sell rule, under which slots were given to incumbent carriers, while new entrants now have to purchase these same slots from incumbents. DOT has been promising to change the

rules for some time, but a serious rulemaking has not been undertaken as yet. Action could help alleviate this barrier to entry for new entrants.

This hearing and others that will occur in the coming months will be seeking solutions to these problems. The specific issues addressed in the bill, though, are only part of the problems we must confront. Issues like trust fund spending must be addressed first and foremost. If the trust fund is used for the purpose for which it was intended, and the surplus is spent, the barriers to entry should begin to come down, hopefully resulting in a more competitive industry and one that adequately meets the needs not only of those people living in "hub" cities, but also of those living in small- and medium-sized communities spread throughout South Carolina and the rest of the country.

I look forward to hearing from the witnesses today.

OPENING STATEMENT BY SENATOR PRESSLER

Mr. Chairman, I am pleased to participate in this second hearing on S. 1741, the Airline Competition Enhancement Act. Though I am not a member of this subcommittee, I am a cosponsor of the bill and take a great interest in the subject of competition in the airline industry.

The focus of today's hearing will be a recently released report from the U.S. Department of Transportation on airline competition. The final analysis of that report is that many passengers are benefitting from airline deregulation. However, I am pleased that the DOT study closely resembled recent General Accounting Office (GAO) reports that yields are considerably higher at concentrated hub airports.

On a related note, I would like Mr. Shane to address the subject of corporate discounting by airlines. A recent *Wall Street Journal* article dated March 12, 1990, p. B1, and entitled "Big Companies Get Fat Travel Discounts, But Small Firms and Consumers May Pay."

The story demonstrated how large corporations receive a discount on more than a third of their airline tickets. I am concerned that this practice will lead to higher travel costs for leisure and small business travelers. Within the context of competition in the airline industry, I would like to know of DOT's thoughts on this practice.

I look forward to today's testimony and thank the chairman for scheduling this hearing.

Senator FORD. The first witness this morning is the Honorable Jeffrey Shane, Assistant Secretary for Policy and International Affairs, Department of Transportation.

Jeff, I guess you have heard the Senators up here and I know it does not bother you at all. So you go right ahead and give us your statement. If you want to highlight it, we will put the full statement in the record, and we appreciate you coming this afternoon. You may proceed. Would you identify your colleague. That would be fine for the record.

STATEMENT OF JEFFREY SHANE, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY PATRICK MURPHY, DEPUTY ASSISTANT SECRETARY

Mr. SHANE. Thank you very much, Mr. Chairman, and good afternoon to you and to Senator McCain and Senator Kasten.

With me this afternoon is Mr. Patrick Murphy, who is Deputy Assistant Secretary of Transportation for Policy and International Affairs. I have asked him to sit next to me this afternoon because we could not figure out how it would be possible for him to pass me notes across the press table without those notes finding their way into print.

With your permission, Mr. Chairman, I would like to submit a full statement for the record, and I will summarize that statement.

Senator FORD. Without objection your total statement will be included in the record.

Mr. SHANE. I am very pleased this afternoon to have the opportunity to appear before you and to comment on S. 1741, the Airline Competition Enhancement Act of 1989.

The legislation, of course, is a response to a growing criticism of airline fares and a widespread belief that the airline industry has become concentrated and uncompetitive. A lot of work and a lot of thought went into it, obviously, and the sponsors are to be commended for focusing national attention on this critical issue.

I have had the privilege, Mr. Chairman, of discussing these issues with you and with the subcommittee and with Senator McCain both in this room and on other occasions in private, and I just want to say that I understand completely the spirit with which that legislation was proposed, and we welcome it. We think it is a vehicle for precipitating a very important discussion of a critical national issue.

As you know, Secretary Skinner has had similar concerns, and it was for that reason that he asked his staff to undertake a comprehensive assessment of the state of competition in the domestic airline industry, the study to which you have referred.

The result was a multi-volume report issued in February. Although the report took nine months to complete, we think it was well worth the wait because it gave the Department of Transportation, and it gave the people of this country, a much better understanding of the complex ways in which the airline industry has changed over the more than ten years since deregulation.

I would like to go over some of the more significant findings in the study to summarize them if I may because I think they bear directly on the issues addressed in S. 1741, and then in the time remaining I would like to simply summarize our reactions to the specific provisions of 1741.

One of the most publicized changes has been the initial increase and subsequent decrease in the number of airlines operating since deregulation began. Between 1978 and 1984, the number of carriers operating large aircraft expanded from 30 to 38. The industry then consolidated through mergers and acquisitions so that, in 1988, 29 remained.

In 1978, 13 airlines carried 90 percent of the traffic. The number increased to 16 in 1984, but then dropped so that today after the mergers in 1989, the merger in 1989 of Piedmont into [USAIR], eight carriers account for 90 percent of the industry's revenue passenger miles.

One major reason the number of carriers has declined in recent years is because a fundamental change has taken place in the way carriers operate. All major domestic carriers developed hub and spoke networks to replace the linear route structures which had grown up under regulation.

Hub and spoke networks have affected air travel in several important ways. First, the increase in number of flights to cities of all sizes, but particularly larger cities, has been dramatic.

Second, small cities receive more frequent and more conveniently timed flights than previously, and many small or rural communi-

ties receive service to connecting hubs from more than one major airline or their code-sharing affiliate.

This provides travelers to and from many small communities with a choice of airlines and one-stop routings to most major destinations. The acid test of whether service is better under hub and spoke systems is whether passengers use it. Between 1984 and 1988, 61 percent of all airports, the vast majority of which serve small communities, showed traffic increases.

The hub at Charlotte, N.C., provides an illustration of how service increases when a connecting hub is created (Chart 3). In 1979, Charlotte had nonstop service to 32 communities, 8 of which were small cities and 7 of which could be classified as small or rural communities. By 1989 Charlotte received nonstop service to 73 communities; the number of small cities served was doubled to 16; and the number of rural and small communities served was more than tripled to 23, Charlotte is only one of more than 20 new connecting hub complexes which have developed in the past 6 to 8 years. The nation now has 25 hub airports, whereas in 1978 we had 5.

The only effective way of assessing the state of airline competition, Mr. Chairman, is by examining city-pair markets, the markets traditionally examined in airline competition studies and antitrust analyses.

The expansion of airline service networks that I have just described has resulted in an increase in the number of air carriers competing for passengers in a majority of city-pair markets. In 1988, more than 55 percent of passenger trips took place in city-pair markets served by three or more competing air carriers, up from 28 percent in 1979.

It is probably not an overstatement to say that in 1988 the airline industry structure was generally more competitive where it counts—in city-pair markets—than at any time in its history.

The lesson to be learned is that you cannot infer less inter-carrier service competition between cities just because there are fewer carriers operating nationally.

As a further illustration of how the industry structure has become increasingly competitive, a look at actual passenger travel in one relatively small market—Albany, New York-Minneapolis-St. Paul, Minnesota—is helpful (Chart 5). In 1979 travelers between Albany and Minneapolis relied on connecting service offered by just two carriers—USAir through Buffalo and American through Chicago. By 1988 air travel between these two cities had increased by 41 percent and two additional competing carriers had entered the market—United, with service over Chicago, and Northwest, with service over its Detroit hub. (USAir's service is now provided over its Pittsburgh hub.)

As you know, each hubbing carrier enjoys a substantial advantage at its hub. Each additional spoke strengthens a hub by providing a new destination for the other spokes. This leads naturally to one airline providing most of the flights at its chosen connecting hub. Since flights into the hub city carry both passengers travelling between spoke cities and passengers destined for the hub city, the hubbing airline can provide more service than local passengers alone would justify. Other airlines generally cannot match the service of the hubbing airline or achieve its load factors into its

hub city. As a result, direct nonstop competition into these connecting hubs is generally limited to markets involving the connecting hub of another air carrier. On the other hand, each connecting hub network competes for traffic in many markets by providing convenient one-stop service alternatives. These alternatives are less attractive to time sensitive travelers in short distance markets, but increasingly attractive as market distance increases.

Let me turn now to pricing. In the ten years since deregulation, air fares adjusted for inflation have continued their long-term historic decline. After 1981, following an increase in air fares caused by an enormous increase in the cost of jet fuel, air fares declined by 26 percent (adjusted for inflation).

From 1984 to 1988 the decline was 15 percent. In this more recent period cities of all sizes had fare declines, but small cities benefitted the most.

Over the period of deregulation average fares have closely tracked average costs. Our study showed, however, that the presence of competition in city-pair markets does affect price.

Among the 3,675 markets in 1988 that had at least 10 passengers per day moving in each direction, 698 were dominated by a single carrier, and fares in these single-carrier markets were 14 percent higher than in competitive markets. These single-carrier markets account for about 10 percent of domestic revenue passenger miles.

We also studied the eight most concentrated hubs, where one airline had more than 75 percent of passenger enplanements. We found that fares at those hubs were on average 18.7 percent higher than in similar markets for other airports. We accounted for differences in the size of markets and distance of markets in calculating this hub premium, which is the main reason why our result shows a somewhat lower premium than the General Accounting Office found in its estimate of last June.

We found that fare premiums at these eight hubs were greatest for travel between large cities within the range of 250 to 1,000 miles of the hub.

Traffic in the high fare markets at these eight hubs represents 4.1 percent of domestic revenue passenger miles.

We have studied other areas as well. Our study analyzed airline marketing systems, including computer reservation systems, travel agencies and frequent flyer programs. We concluded that the basic features of CRS industry structure are unchanged over the past few years and entry into the CRS industry remains difficult.

There are, however, two promising CRS developments. First is the diversification of ownership of three of the four reservation systems. To the extent that these systems are owned by more than one airline and are operated as separate profit centers, managers' incentives and abilities to use these systems to thwart airline competition are reduced.

Second is the enhanced ability of these systems to provide real time information on the flights of participating airlines which could, potentially, reduce the need for travel agents to use the locally dominant air carrier's reservation system.

The Department has rules restricting the airlines owning CRSs from using their control of the systems to prejudice their competitors. As you know, the Department is currently considering wheth-

er to readopt or to amend those rules, which are now scheduled to expire at the end of this year.

As I say, we looked at frequent flyer programs. We also studied regional airlines. We studied the impact of international air service on the domestic market, and finally we studied airport and air traffic impediments to competition.

The travel agency industry has grown dramatically under deregulation. Before deregulation travel agents booked 51 percent of U.S. airline passenger sales compared to 81 percent in 1988, and the number of agency locations has grown from 14,800 to over 35,000. Travel agencies are a relatively inexpensive means for marketing airline services; without the agency system each carrier would have to create its own distribution network, an arrangement that would be considerably more costly. The agency system is still evolving, and travel agencies have been developing new services for clients, including services that can significantly lower travel costs.

Frequency flyer programs are a form of discount directed toward the most lucrative segment of airline traffic—the full fare business flyer. These programs probably make a contribution to airline efficiency by using awards so as to fill seats that otherwise would have been flown empty. Pursuit of frequent flyer rewards by company employees can lead to distorted purchasing decisions by business travelers, but corporations are adopting control measures that they believe are reducing these problems. Also, most frequent flyers belong to more than one program, thus helping to promote competition among carriers.

A separate section of the study covering regional airlines found that the number of airports served by this carrier group increased by 25 percent between 1978 and 1988 and the number of passengers carried by the regionals more than tripled. Most regional airline services is marketed on a code sharing basis with a major airline which provides greater coordination between carrier flight schedules, allows shared boarding and baggage facilities, simplifies ticketing, and permits passengers of regional air carriers to participate in frequent flyer programs offered by major carriers. Most regional travel markets are competitive. Of the top 300 regional markets in 1988, our study found that 212 were served by two or more air carriers, and in another 24 markets regional airlines compete with major air carriers.

The impact of international air service on domestic competition was also studied. We found that international operations are a growing source of revenue and profits and are important to the financial strength of the individual domestic carriers. The introduction of new gateways and additional opportunities for international travel has resulted in substantial increases in traffic and has altered traffic flows, with more passengers traveling on-line and fewer making interline connections between domestic and international sectors.

Finally, our study included a section on airport and air traffic impediments to competition. We found that delays resulting from airport and airway capacity restrictions are a serious concern, but in and of themselves do not prevent new carriers from gaining airport access beause the "first come, first served" rule of handling traffic treats new entrants and incumbents the same. With regard

to the four slot controlled airports—O'Hare, La Guardia, Kennedy and Washington National—inadequate capacity is an obstacle to expansion by incumbents and entry by new carriers. Reallocation of slots is now accomplished through a market-type process that allows slots to be transferred for any consideration. This "buy-sell rule" has been effective in providing for adjustments among incumbent carriers. However, the capacity shortage at these airports may well impede carriers from entering these markets.

We also found that a shortage of airport groundside facilities is a serious problem. According to a 1989 survey conducted by the Airport Operators Council International, 19 of the 30 large hub airports indicated that no gates could be made available within 90 days.

Section 2 covers computer reservation systems and code-sharing. As I noted earlier, the Department is well along in the rule-making process to consider changes to its CRS regulations which expire at the end of 1990. Comments have been filed by 27 parties and the issues raised, not surprisingly, are very complex. Consequently, the Department will not be in a position to make substantial comments, or substantive comments on CRS issues until that rule is done, and I can only apologize for that.

On the issue of outlawing code-sharing, our views are clear. Our study of structure and pricing in the industry and our review of the regional airline industry led us to conclude that code-sharing has usually been a positive development, which has produced not only better service but also more competitive options for many smaller cities and rural communities.

Section 3 of the bill would give the Federal Trade Commission authority over deceptive and anticompetitive practices in the airline industry. That will duplicate, Mr. Chairman, the Department's authority under Section 411 of the Federal Aviation Act, and with respect to anticompetitive practices, would overlap both the Department of Transportation's and the Department of Justice's authority. We see no reason why this increase in overlapping authority would lead to better regulation or enforcement, and consequently, we would be opposed to that section.

Section 4 creates a presumption that a dominant air carrier at a concentrated hub airport has been engaged in unfair or deceptive practices, or unfair methods of competition, and Section 5 authorizes the Secretary to move in district court for an injunction against those practices.

Again, our study of the industry led us to conclude that the hub-and-spoke system of organizing routes has generally produced more and better service at the hubs and more competition in most domestic markets than would otherwise prevail. Therefore, we believe it would be unwise to simply presume guilt based on market share. The current antitrust laws we think provide a method for correcting monopolistic, unfair or deceptive practices, and they should serve us well when those practices arise.

Section 6 allows the assessment of passenger facility charges, or PFCs, at concentrated hub airports to be used for security, capacity enhancement and noise mitigation projects. Bearing in mind your own comments on the PFC proposal, Mr. Chairman, the Department of Transportation agrees in concept with that section, but we

see no reason to limit PFCs to certain airports—that is to say, the high density airports.

Our competition study and our national transportation policy review indicate the need to expand airport and airway capacity. For this reason, the Department included in its proposed reauthorization legislation for the FAA a provision that would allow airports to collect a PFC of up to $3 per enplaning passenger, which in the first year could be spent for purposes currently authorized under the airport improvement program.

Our proposal would also allow the Secretary, after the first year, to permit higher PFCs and permit their use for non-AIP eligible airport improvements that help eliminate air transport system problems. I will not go into the many details of that proposal today. I would simply note that our proposal is more expansive than the PFC proposal in S.1741. We believe that that new revenue source is necessary if we are to significantly progress toward meeting the growing needs of the air transportation system.

Section 7 would require the Department to revoke and reallocate all slots by periodic auction. While this may have the positive effect of generating more funds for airport development, it would not alter the fundamental problem at the four airports subject to the high-density rule—that is to say, a lack of capacity.

Since the existing rule already provides a buy-sell mechanism, the Department is trying to determine whether this approach would change the way the potential users of the slots value them, or whether it would result in a more competitive outcome than currently exists. It may simply result in lower profits for carriers, or higher fares for consumers.

The conclusions of our competition study, Mr. Chairman, reinforce the themes of the Administration's national transportation policy. Deregulation works. Letting competition flourish in transportation markets brings benefits to the traveling public, to our Nation's domestic economy, and to our competitive position in the emerging global marketplace.

Any effort to reregulate would do more harm than good. Instead, we believe the emphasis should be placed on expanding airport and airway capacity so opportunities for introducing new service by new and existing carriers are not foreclosed. In areas where the Department now exercises some direct control and oversight, such as in the allocation of slots and CRS rules, any action we take will seek to promote competition.

Actions we take in developing international policy and other related statutory responsibilities must take into consideration the impact on domestic competition. We would expect abuses of market power to be dealt with by enforcement of the Nation's antitrust laws, and will of course provide technical advice and data to support the Department of Justice in that objective.

Thank you very much, Mr. Chairman, for the opportunity to present our views, and of course I would be very happy to comment and answer any questions Subcommittee members may have.

[The charts referred to follow:]

CHART 1

CARRIERS OPERATING LARGE AIRCRAFT
1978, 1984 and 1988

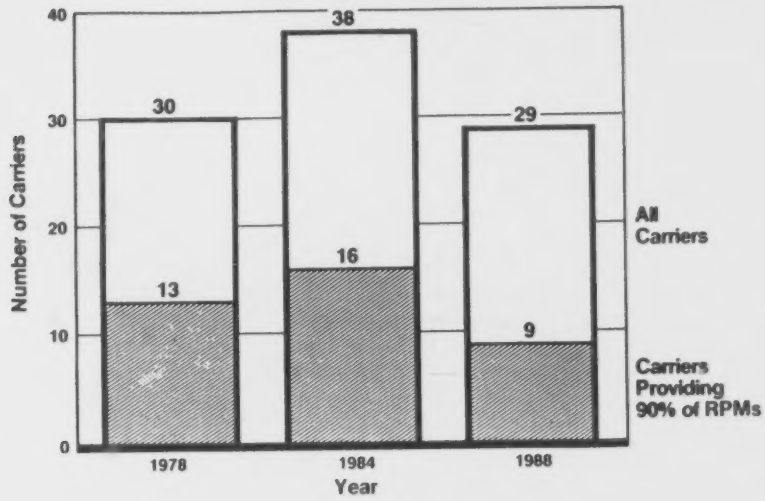


CHART 2

GROWTH IN WEEKLY FLIGHTS
1978 – 1989

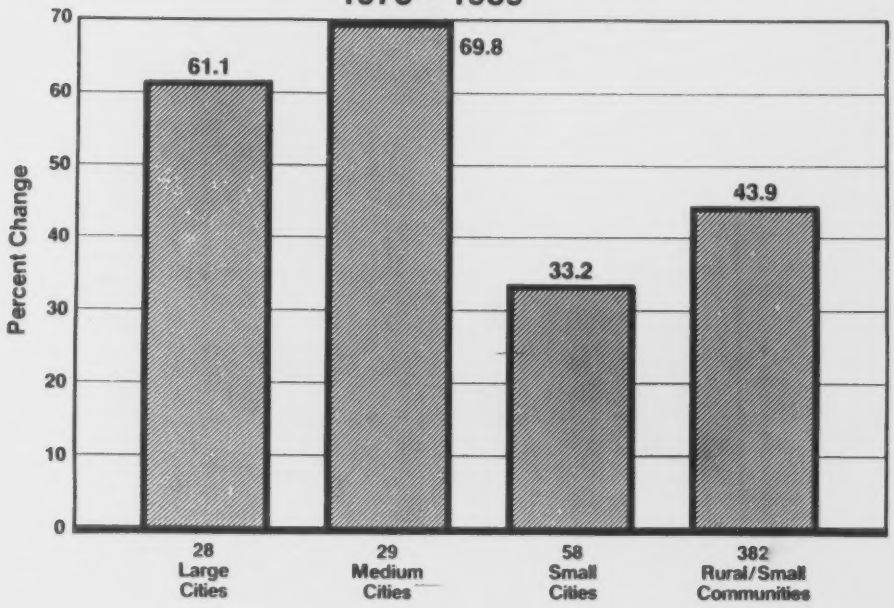


CHART 3

SERVICE AT CHARLOTTE

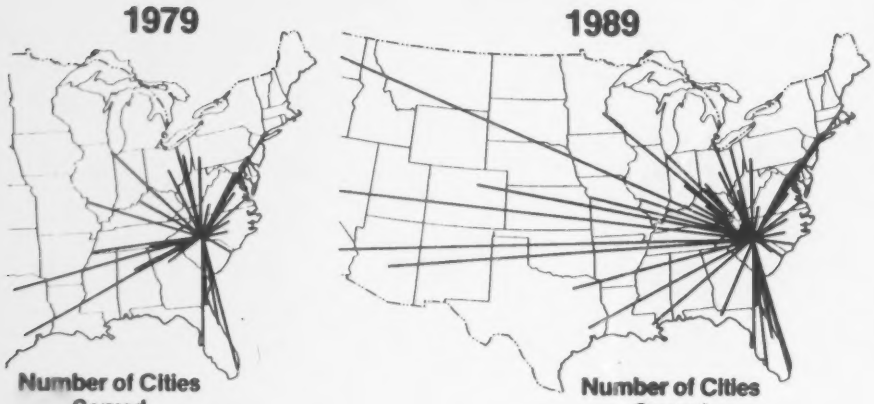


CHART 4

PASSENGER TRIPS BY COMPETITIVE STATUS

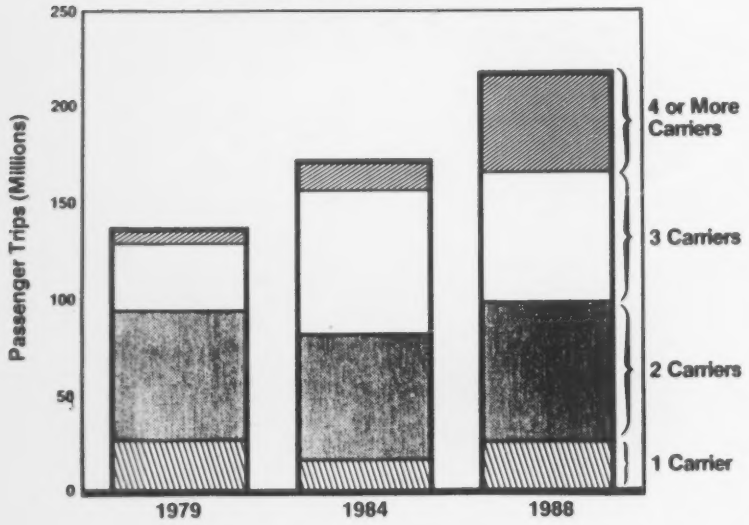


CHART 5

PASSENGER FLOWS OVER CONNECTING HUBS

Albany - Minneapolis Market

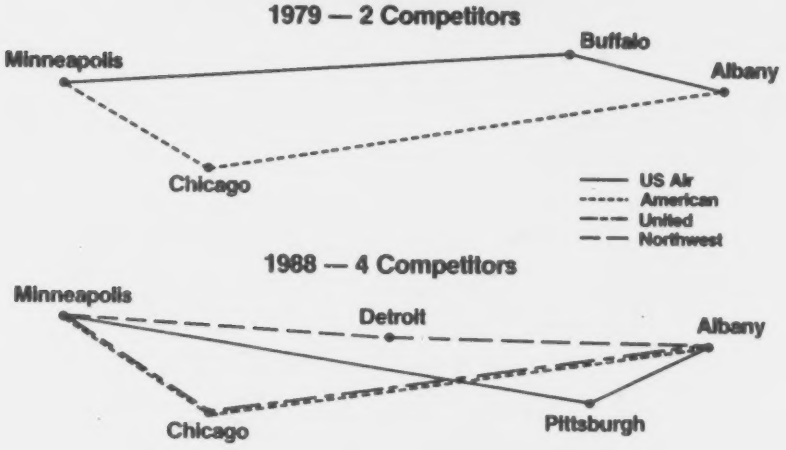


CHART 6

AVERAGE DOMESTIC PASSENGER FARE PER MILE

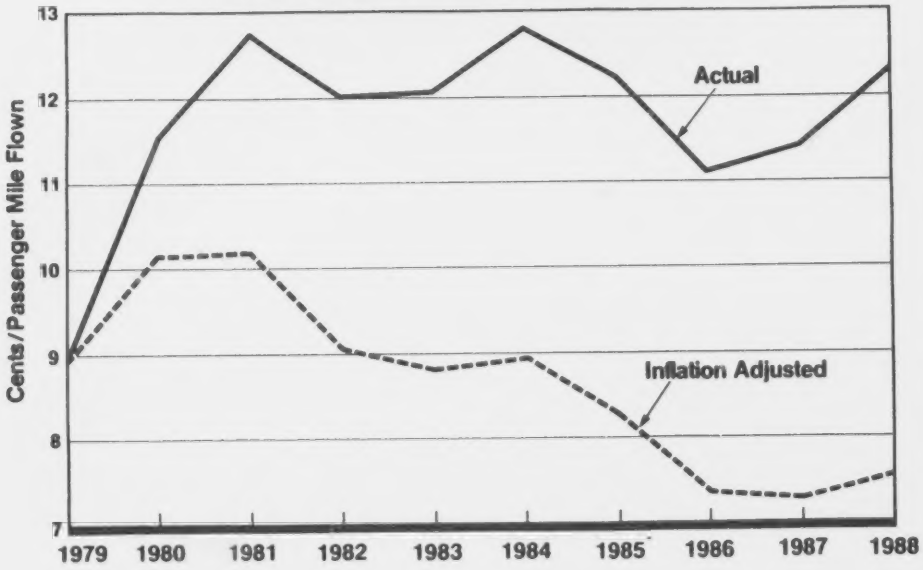
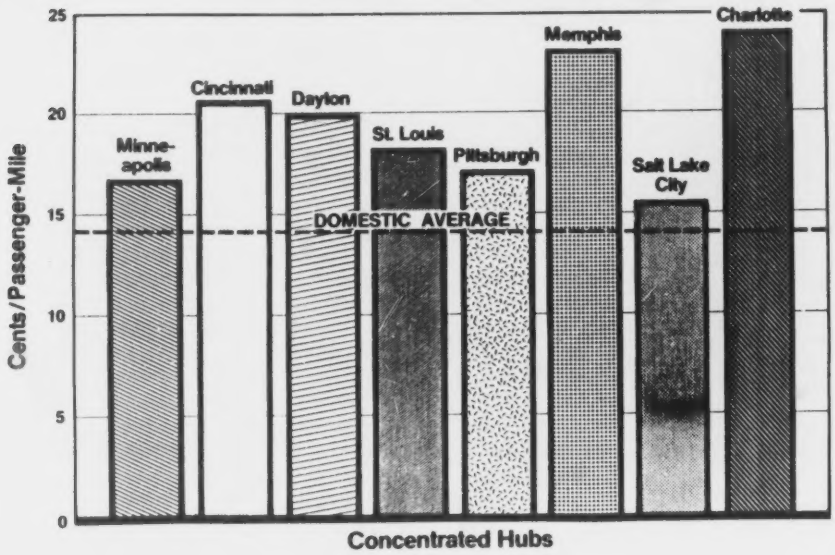


CHART 7

AVERAGE FARE PER MILE AT CONCENTRATED HUBS

Compared to Domestic Average



Senator FORD. Thank you, Mr. Shane. We have been joined by the distinguished ranking member of the full Committee and one of the sponsors of the legislation before the Committee today. Senator Danforth, if you wish to make an opening statement before we get to questions, I would be delighted to entertain it.

Senator DANFORTH. I have no opening statement, Mr. Chairman. Thank you very much for holding the hearing.

Senator FORD. Thank you, Senator. I have three or four questions, Mr. Shane, and then I will let my colleagues question you. Does it concern you that the three top carriers seem to be pulling ahead of the pack, if I may use that term?

They accounted for about 90 percent of the profit last year. They carried 45 percent of the domestic market and have more than half of all the aircraft on order. Given the lack of new entry, does the Department believe that this situation should be addressed either with regulatory action or legislation?

Mr. SHANE. There is not any doubt but that the competition that we have seen over the past decade has produced the kind of success stories that you are describing. The study that we have done highlights the importance of, again, competition in city-pair markets.

The fact that you have a smaller number of carriers competing nationally, that is a smaller universe of airlines in this country, is not, in our judgment, the most important statistic. The most important statistic is the extent to which those carriers, however many there are, are competing in particular city-pair markets.

The burden of the Department of Transportation's study is that there is in fact more competition in more of those city-pair markets today than ever before, so that the fact that you do have some leviathans in the U.S. airline industry now, which are present in a great many city-pair markets, does not cause, by itself, concern, as long as their presence is accompanied by real competition.

I do not mean to suggest by that answer that we should simply relax and allow trends that may in fact be troublesome to proceed without keeping a very watchful eye on them. The prospect of reregulating the marketplace today, though, I think ought to be resisted. There is not any regulatory scheme that we have been able to think of, as I said in my opening statement, that would not do more harm than good.

That is not, if I may say, Mr. Chairman, the product of mere mindless ideology. If I can be personal for a moment, I grew up in a regulatory environment and cut my teeth in Washington a quarter-century ago as a rate regulator at the old Federal Power Commission.

I have practiced regulatory law before the ICC and the CAB and the Federal Maritime Commission, and I speak with some conviction when I say that that regulatory process does not solve very many problems.

We did an ingenious thing in 1978 and we need to have confidence in our wisdom at that time, provided that the benefits of regulation continue to be present and provided that we, as I say, keep our eye on the picture.

Senator FORD. With all of your experience, Mr. Shane, you ought to be able to jog some of the folks over at the Department of Transportation to move a little faster, since you have been on both sides

of the bar. It bothers me that they have not. Could you give me an estimate of how many studies Secretary Skinner has had since he has been Secretary of Transportation?

Mr. SHANE. Big formal ones, or little informal ones?

Senator FORD. Well, just however many. He has always delayed everything on studies. He just studied everything to death. Give me a guesstimate on big ones and little ones. Never underestimate the insignificant.

Mr. SHANE. The fact is that the Secretary has distinguished himself in my mind in being unprepared to move on any problem until he has the necessary data in front of him. The first big assignment, of course, for the Secretary was the establishment of a national transportation policy for this country, and that was one of the most important events in the history of the Department of Transportation. He created an entirely new organization out of the existing bureaucracy to do that.

I think second in his mind is the study of airline competition to which we have been referring this morning. I do not think there has been a more comprehensive study done of airline competition. I can say that for sure within the Department of Transportation, and I would even venture to say that it is the most comprehensive study done by anybody, and it is an important study, because it provides the predicates that we now need to formulate informed judgments about what steps can be taken from here on in.

There have been a variety of other assignments, but I do not have that at my fingertips. But everything we do in the Department is meant to be based on some knowledge of the subject before we jump.

Senator FORD. Well, it indicates that his highway policy was that here it is; and if you States want it, you pay for it. Hell, he could have done that when he came into office, and that does not impress this Senator a whole lot.

You can organize and do all these good things and paint this picture out there, but if the States are interested in having those things then they have to pay for it themselves. When you look at States and what they are trying to do—the educational system and other needs—many States are increasing taxes and just creating political heat for all the officeholders, but they are willing to bite the bullet and go right on with it.

It seems to me that the studies are revealing a great organization, but they are not finding ways to complete the structure. You gave me two studies, and I can give you a lot more in the reorganization of the reorganization of the reorganization. It gets to be a little old, not only to us but to the employees in the Department.

So I would hope we could steady ourselves here, and once we make the study try to accomplish something as a result of the study. People, as I said in my opening statement, expect us to do something after you study it. So nine, ten months, 11 months, a year or so, we ought to be moving in some direction, rather than saying everything is all right except a couple of soft spots.

Mr. SHANE. Mr. Chairman, we came out with a national transportation study—national transportation policy in March, and within two or three weeks we had the first real product of that study appear, and that was the Administration's FAA reauthoriza-

tion package, which proposes a 72-percent increase in Federal funding of aviation over the next five years. That did not sound like abdication of the Federal responsibility.

Senator FORD. It abdicated the responsibility, because you said increase the tax from 8 to 10 percent, increase the fuel tax and allow airports to charge head taxes. You did not do anything except say: if you want it you have to pay for it—$22 billion over five years.

Sure, and you got $7 billion in surplus in the Trust Fund. Now we will wind up with $15 billion in the Trust Fund to try to make the deficit look better. I do not understand how you can call that a policy, when you start taxing people when you have a surplus in the Airport Trust Fund. If that is the policy, everybody can ask for an increase in taxes.

Mr. SHANE. Well, the idea was that everybody would pony up more, including the Federal share. The Trust Fund would be spent down to a surplus of about $3 billion at the end of the five years, and that is a five-year program. So that is as far as it goes, but it would certainly tap the Trust Fund to a greater extent than has been the case in the past. And with the PFCs we are talking about a program that would put something like $18 billion into airport capacity development over five years. I must respectfully disagree that it is simply shoving the problem onto the States and local governments. It is offering to strengthen the partnership.

Senator FORD. Well, it does not strengthen the partnership by increasing taxes when you have a surplus. If your economic people cannot guess any better than want a $3 billion surplus in case of wrong estimates, I believe I would get me some other people over there to make judgments for you. Three billion dollars is an awful lot of money and would help an awful lot of airports.

Mr. SHANE. Well, we have been arguing within the Administration about that, as you know, and we thought that it was not a bad compromise to say we will spend down the Trust Fund to the tune of $3 billion by the end of the first five-year period.

Senator FORD. You are spending down the Trust Fund surplus by $4 billion and you are going to use up everything that comes in, plus the new taxes; is that correct?

Mr. SHANE. That was the scheme, yes, sir.

Senator FORD. That was the scheme? You are not sure that is going to happen?

Mr. SHANE. Well, that is what we propose to the Congress.

Senator FORD. Well, I am not sure you are going to get the taxes, but we will see about that later.

A study by the Economic Policy Institute claims that in 1989 consumers are estimated to be paying "roughly 2.6 percent more than they would be paying under the pre-deregulation trend per mile" and that in many markets coach fares have increased by more than 50 percent. How do you reconcile this with your study, which says that air travelers have benefited by more service at lower cost?

Mr. SHANE. I think the EPI study looks at only one factor in trying to project that so-called long-term trend, and that was fuel prices. They extract a long-term trend from what happened in the decade before deregulation, if I am not mistaken.

In the decade before deregulation, we did something very important in the aviation industry. We invented the turbofan engine, which had the most dramatic decreasing effect on airline cost of any single event that has taken place since the advent of jet air transportation.

There is no reason to think that there would have been another watershed technological improvement of that kind in the next decade. I do not know of any, so we cannot buy the assumption of a long-term downward trend just from the fact that we experienced some downward trends before deregulation.

We think that there would not have been that same long-term downward trend. To the extent that there are some markets which have experienced increases in fares, we acknowledge that in our study. There is no question but that the CAB, when it was regulating fares, was cross-subsidizing, was holding fares down artificially below costs in a number of markets, short haul markets in particular, and extracting higher than true cost-based fares in other markets.

That no longer takes place. It is a market-based system. Nobody is regulating those fares, and so there are some definitely increased fares in some markets. That is necessarily to be expected from a deregulated marketplace.

Senator FORD. Well, it is concerning a lot of us about the increased cost. And it is very hard for us to reconcile your statement and the actual fare that you purchase. And most of us purchase tickets every week.

What do you think of the suggestion that the government should impose an industry mileage-based formula for assessing reasonable fares in a market, where a carrier has more than a certain percentage of the traffic in the market?

Mr. SHANE. I think it would just begin to sap the kind of energy that we have seen come into the airline industry since deregulation. We think that trying to get into the business of regulating fares again, the mistake that we made under regulation, is a step that ought to be avoided.

Senator FORD. Well, let me ask you my final question, Mr. Shane, and this has bothered me for the last several days. And I hope you can give me an answer without trying to sidestep it. I find that, in addition to studying competition, the Department is making some odd decisions.

On March 23rd, the Department granted Discovery Airways temporary authority to operate, despite the fact that it is almost completely financed and owned by foreign entities, and despite the fact that DOT has questions about Discovery's compliance.

Can you explain why any certificate to operate was granted under those circumstances?

Mr. SHANE. Yes, sir. We have been talking this afternoon about the importance of stimulating new entry in our market. The Department of Transportation has to take seriously any genuine application by a new airline to come into any market.

We are not opposed, as a nation, to investment of foreign capital in the U.S.

Senator FORD. Would you repeat that statement?

Mr. SHANE. Investments of foreign capital into U.S. businesses is something that we as a nation welcome.

When we talk about the airline business, we have a law that says foreign entities may not exert control over the management of U.S. carriers. You are talking to the same Department of Transportation that was accused last summer of almost bringing down the stock market because of the way in which we compelled the divesture of some KLM stock from a transaction in Northwest Airlines.

Senator FORD. And Secretary Skinner also said in testimony in Room 301 of this building that if he had the leveraged buyout legislation in place, the KLM-Northwest problem would not have happened. And yet the Administration is opposed to the legislation.

Now the Department can only jawbone or jerk the certificate away. And Secretary Skinner cannot even endorse legislation that would help him because the Administration is opposed to it.

Now you may have thought you were tongue lashed then, but you are going to get it a little bit harder under the circumstances I see here.

Mr. SHANE. Mr. Chairman, what Secretary Skinner did in the case of Northwest Airlines was specifically require as a matter of law the divestiture of a certain amount of KLM stock because of his concern about control. That was not jawboning. That was a consent order issued by the Department of Transportation.

Senator FORD. That was because of foreign ownership, a foreign percentage?

Mr. SHANE. Foreign control.

Senator FORD. All right. What about 100 percent, then, of foreign ownership in Discovery Airlines?

Mr. SHANE. The question of how much foreign ownership there is in Discovery Airlines is precisely the question that the Department of Transportation has placed before an administrative law judge.

Senator FORD. Well, why did not you hold the certificate up until you were sure that it was not more than 25 percent?

Mr. SHANE. We thought about doing that. And that was a hard call.

Senator FORD. Well, I thought that was your regulation. I thought that was what you were supposed to do.

Mr. SHANE. The airline management maintained that the money invested by one of the principals was money provided by a U.S. citizen for a U.S. airline. Now I know that that is a disputed allegation, and it is because it is a disputed allegation that we decided to set that particular allegation for hearing.

Senator FORD. Why did you not withhold the certificate then? You allowed an airline with a real big question as it related to foreign ownership, you put it before a law judge. You want to get the question answered, but you went ahead and certificated it so that it could go into competition.

Mr. SHANE. Well, we are not against competition.

Senator FORD. Now it seems to me you are giving preference to foreign investment, and you are not taking care of American investment.

Mr. SHANE. Well, no American investment was jeopardized, as far as we could tell.

Senator FORD. Well, it is in competition with American money, and there are American owned airlines in the same area. Now if that is not jeopardizing American investments, I do not know what it is.

Mr. SHANE. Well, we are for competition, Mr. Chairman. We rather hoped there would be competition in that market. The issue is whether or not the airline that is competing with the airlines that are out there right now is a foreign-controlled airline. If it is, then it will not be a foreign-controlled airline very long. And that is what the law provides.

Senator FORD. But are you going to let him have a certificate, fly six weeks, and then shut him down?

Mr. SHANE. If necessary, that is what we will do. And the carrier understands that.

Senator FORD. Why did you not go ahead and find out beforehand, before you allowed him to enter the market, and then shut him down after you have had an investigation made?

Mr. SHANE. That was an option.

Senator FORD. You decided to not take that option, though?

Mr. SHANE. We decided to not take that option on the ground that we may have lost a potential new entrant if we had taken that option.

Senator FORD. Well, it is obvious to this Senator you are more interested in providing competitive opportunity for foreign investors than in protecting U.S.-owned air carriers. And so I am very much concerned about that, and we will get into it a little bit deeper. And I pass the questioning on to my friend, John McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Just as a follow up, Mr. Shane, you are an expert on international aviation, among other things. Do you think that it would have been possible for Hawaiian Air to set up an airline route network in the Japanese Islands?

Mr. SHANE. Certainly not.

Senator MCCAIN. You do not think so.

Mr. Shane, on page six of your statement, you state, "Our study shows that the presence of competition in city-pair markets does affect price. Among 3,675 markets in 1988, 698 were dominated by a single carrier and fares in these single-carrier markets were 14 percent higher than in competitive markets."

Then you say you also studied pricing in concentrated hubs by analyzing fares of the eight most concentrated hubs. "Where one airline had more than 75 percent of passenger emplanements, we found that fares at these hubs were on an average 18.7 percent higher." That is your statement.

Mr. Shane, there are now basically five major airlines remaining, if you believe the analysts, that Pan Am, TWA and Eastern are in serious trouble, five major airlines now control about 90 percent of the traffic. Do you agree with that?

Mr. SHANE. While they may be in trouble, they are controlling a lot of the traffic. I think it is still eight airlines controlling 90 percent of the traffic.

Senator MCCAIN. If those airlines no longer remain viable, which most analysts believe that they will not, then we are down to five airlines with 90 percent of the traffic. My point is therefore, then

you have more and more situations such as you have just described: hub concentration and lack of competition in city-pair markets. It is bound to happen if we have fewer and fewer airlines, obviously.

Now in the GAO report, they state, "flights at airports where entry was limited by slot controls had, on average, about 7 percent higher air fares. The larger an airline's share of the computerized reservation system in a metropolitan area, the larger its market share in routes from airports in that area."

In other words, GAO is concluding in their statement, as they will testify, that where there is a market concentration, and where there is hub concentration, there are higher fares. We are now seeing reduction in numbers of airlines.

It seems inevitable, then, we are going to see monopolistic practices return. And apparently, according to your statement, you have very little solutions to offer except expansion.

The GAO's response to expansion is that they have two problems. First, that other factors were significantly related to fares as well, such as share of gates leased. Second, airport expansion takes time.

My point is, Mr. Shane, things are happening out there that airport expansion will not take care of. And we are now entering a de facto reregulated environment if indeed GAO and your conclusions are correct, that where there is airline concentration there is increases in fares.

And I am not clear as to how you expect to solve this problem except, as you say, through airport expansion. And I happen to agree with the GAO, that simply airport expansion, given the time that it takes and other factors involved, will not solve the problem.

Do you have a response to that?

Mr. SHANE. There is no question that airport expansion takes a long time, and therefore it cannot be considered a satisfactory answer. I guess what we have to remember is that at the present time, the percentage of domestic revenue passenger miles found in those 698 city-pair markets which are dominated by a single carrier is about 10 percent.

The city-pair markets that are associated with the eight most concentrated hubs, the ones which have the highest percent increment over average fares, represent something like 4 percent of the domestic revenue passenger miles.

It is not the main story in the airline competition picture today. It is significant. It is important. But it is, if you will, aberrational in terms of the broad result that we found in our study of the airline competition picture across this country.

Senator MCCAIN. And yours is a snapshot, and frankly, Mr. Shane, I am concerned about trends. Take code-sharing, for instance. You say that code-sharing is a fine thing and it has helped. But GAO concludes carriers with a code-sharing agreement at one of the major airports on a route charged fares almost 8 percent higher than carriers did on routes which did not have code-sharing agreements.

On CRSs, you report that the airline ownership of CRSs conveys a number of benefits on vendor airlines. You conclude that there is

between $2 billion and $3 billion transferred to those airlines that control the CRSs.

But, very frankly, the trends are increasingly towards fewer and fewer airlines, greater and greater hub concentration, and fewer and fewer slots available. We know that in the slot area, that you are not going to expand National Airport. We are simply not going to do it. So we are going to have slots for a long time here.

Some action has to be taken besides relying on the marketplace in my view.

Let me just add. Your report cites two promising developments in the CRS field. First, is the diversification of ownership in CRSs. And you state, to the extent that these systems are owned by more than one airline or operated as separate profit centers, managers' incentives and abilities to use these systems to thwart airline competition are reduced.

I assume this comment is based on some evidence of this practice. Would it not be better to have these systems as totally separate profit centers, so there would be no ability to thwart competition?

Mr. SHANE. Well, I guess what I was saying was that that seems to be happening, more or less, that when an airline sells portions of its system to its competitors, it loses the kinds of control that we were all concerned about when you had single airlines dominating single systems. That seems to be a trend for the future. And it is happening abroad as well as in the United States.

And we are even seeing some non-airline vendors expressing real interest in getting into this computer reservation system business, and for reasons that do not have anything to do with airlines. It is an enormously interesting technology to a whole host of businesses.

Senator MCCAIN. It is so interesting that one of the airline executives was quoted as saying if he had to sell his airline or his CRS, he would dump the airline.

Let me talk about the buy-sell rule with you for a minute if I could. You are saying that the buy-sell rule is working. My information is that the uneven transfer list reveals that over the last few years, with the exception of large deals surrounding Eastern's demise, there has been no market as far as the buy-sell rule is concerned.

Is this correct?

Mr. SHANE. Well, I do not think I meant to say that the buy-sell rule was the end of the story, as far as the Department of Transportation is concerned. As Senator Kasten has pointed out, there is a rulemaking in process at the Department, and we anticipate a review of buy-sell in the context of that rulemaking, when it is finally completed.

Senator MCCAIN. I am sure I have taken too much time, Mr. Chairman.

Senator FORD. Go ahead.

Senator MCCAIN. Let me just say again, Mr. Shane, we have, I think, an evolving trend which is clear to all observers of the airline industry. I do not claim to know all the answers. As I said in my opening statement, the legislation that Senator Danforth and I and others proposed, is not embedded in concrete. But some action has to be taken to stop this trend.

And to take a snapshot as you did in your study, and say, "well, everything is going to be fine," and "we oppose all options," frankly, is something that I think is a very serious mistake. And I am not for reregulation, but there is no doubt in my mind we are going to get the worst of all worlds, and that is de facto reregulation, with a smaller and smaller number of airlines who dominate hubs, which dominate major airports, and therefore, raise rates at their whim.

And to just simply say the marketplace will prevail when there are clear, severe limitations in concrete, in places to land, and in ability of new airlines to enter the market. And I think your study is not an accurate depiction of the situation. And so I hope you will review the GAO findings, at least, if not the opinions of the members of this committee, and take them into consideration in your decision-making process.

I thank you, Mr. Chairman.

I thank the witness.

Senator FORD. Senator Kasten.

Senator KASTEN. Mr. Chairman, thank you.

Mr. Shane, why did you not decide in your airport trust fund to spend more of the $7 billion or $8 billion in the first few years? Or maybe I can ask the question another way. What was the transportation-related reason, not budget-related reasons, the transportation-related reason to end up by spending it down to $3 billion in five years? Why would not you spend it down to $1 billion in five years, or $4 billion in five years?

What was the transportation-related reason for the airport trust fund decision?

Mr. SHANE. The National Transportation Policy highlighted the importance of maintaining and expanding America's transportation infrastructure. And it also highlighted the importance of ensuring that we have in place viable, continuing, reliable mechanisms for ensuring that the money that we need to support that infrastructure is there.

If we would have simply grabbed the trust fund, spent it all out all at once, it would not be, therefore, incumbent upon us to try to figure out how we maintain a responsible system in place, so that we have revenue stream coming in over the long term to finance this infrastructure over the long term.

Senator KASTEN. Well, what is the income from the existing taxes that are now going in? What is the annual income now coming into the system through the present system of taxes, which are on airline tickets and other sources?

Mr. SHANE. I am sorry, Senator, I do not have that.

Senator KASTEN. How much per year are we paying in? What is the revenue in?

Mr. SHANE. I do not happen to have that number at my fingertips. We can either supply it for the record or perhaps Mr. Murphy knows. I am sorry, sir.

[The following information was subsequently received for the record:]

Each year the amount is different. It depends on several things. How many passengers fly, ticket tax, fuel tax, etc. $3.7 billion, 1989 Aviation Trust Fund. $3.9 billion, 1990 Aviation Trust Fund.

Senator KASTEN. I think that with dollars coming in, you can maintain the integrity, if you will, of the trust fund system. And it would seem to me, what is going to happen up here is people are going to say to you, it does not make much sense to us to increase taxes on airlines or the air transportation system if we are not going to first spend the money that we have already been taxed to collect.

You have got a stream of income coming in, and I think the position that we are going to take, or at least this Senator is going to take, is spend the money that you have already taxed people on, who thought that those dollars were being used for airports and FAA and what have you. And first spend the money on the taxes you have already levied, and only then increase the taxes if the tax rate is not sufficient to maintain the trust fund system.

Now let me go back. Why is it that the Department of Transportation has not responded to the law requiring the Secretary of Transportation to come up with a rule-making within 90 days and final rule within nine months? The law was passed in September of 1988.

Mr. SHANE. We came out with a notice of proposed rulemaking, a few months after the law was enacted, in December of 1988. In August of 1989, we went final with one portion of the slot rulemaking, and that was portion that said that commuter air carriers would be allowed to operate the slots that had been operated by larger aircraft.

Senator KASTEN. But the heart of the matter—you are nibbling at one edge of this question.

Mr. SHANE. Well, I am just trying to answer your question.

Senator KASTEN. The heart of the matter is what is happening in terms of the overall slot allocation or reallocation efforts that should be underway at the Department of Transportation?

Mr. SHANE. Well, that is still pending. In March of this year, we addressed specifically the need to transfer international slots from one carrier to another. We had had a rule in place that said that whenever a domestic air carrier needed a slot for a new international flight, it could take it from other domestic carriers at that same airport.

We are saying now that the large carriers that need those slots can take them from their own pool. That was a way of inserting a little justice into the system, if you will.

But you are absolutely right. There is not a final slot rule on the books today. And that is not for lack of a lot of meetings and a lot of discussions within the Department on that subject. It has been a very complicated process. There has not been any subject that has been more important to Secretary Skinner. It is just that we have not been able to thread our way through the thicket of these very complicated issues.

And that is the only answer I can offer you.

Senator KASTEN. I want to read a part of the statement from the Airport Operators' Council International and the American Association of Airport Executives. And they say, "one barrier-to-entry which bears scrutiny is the slot system at the nation's four High-Density airports, which, since 1969, has restricted the number of landings and take-offs. DOT's 'buy-sell' rule compounded capacity

problems at the four high-density airports by giving away valuable slots to incumbent carriers. Buy-sell has created another set of obstacles to entrants and growing incumbents seeking access to these airports, and affects not only those four airports. . . ."

And then they go on, "new entrants, at times"—and this is what we are talking about with a number of airlines, some of whom are going to come before this committee—"new entrants, at times, have paid millions of dollars to incumbents for slots which those incumbents paid nothing. This obviously places the new entrants at a severe competitive disadvantage. In other cases, new entrants were unable to purchase a slot at any price—they are simply 'not for sale'."

And these groups believe that the buy-sell rule and the high-density rule itself should be revisited in order to develop a more equitable market-based method of allocating slots.

Now that is what we are trying to get at. It seems to me there are two ways that we are going to do this. And I think we are going to be forced to legislate it. The first way is to increase the percentage utilization. You have now got it at 65 percent. You have had a proposal, or at least we have discussed proposals that would raised the use or lose percentage for slot utilization from the 65 percent up to 85 percent.

That whole concept is based on the fact—I think it is just a crime that we have got people who are, in effect, baby-sitting these slots, when we have got other people who could use them completely. In other words, they are being held unavailable to keep them unattainable.

There is also evidence that certain people, I think your time frame, correct me if I am wrong, but I think it is three months that you calculate your percentage on. Is it four or three?

Mr. SHANE. I think it is three.

Senator KASTEN. Whatever that number of months is, when a person sees a certain slot starting to fall below that threshold they will reroute that slot in order for a high-traffic plane to come in there for the last three weeks, or something like that, in order to make your 65 percent. Now, either we stop the—for lack of a better word—ability to baby-sit slots, or we increase the threshold percentage from 65 to 85, or we do both. Can we do both?

Mr. SHANE. I do not know the answer to that. You have put your finger on some very important questions. The Secretary has been very concerned about our inability to get a better handle on the actual utilization of slots in real time so that those judgments can be formed. That has been one of the obstacles.

Senator KASTEN. The other way to legislate this is to look at concentration at an airport, and we are trying to determine this also, and simply look at someone, if it is one of the 70 percent airports that Senator McCain was talking about—we have 55 percent or so with two airlines out at National Airport now—and simply say, whoever it is that contributes to the high concentration simply has to give up 10 percent, and we just let them figure out which ones they give up and we legislate that they give up those slots at these high density airports. They did not pay anything for them to begin with, so it should be no problem for us to legislate that they are

used by new entrants or limited incumbents. Would you support that legislation?

Mr. SHANE. I just cannot offer you a comment as to whether we would or would not support it, Senator, but I do not disagree that you are talking about logical options that can be addressed.

Senator KASTEN. What would you support? I just threw out a couple of ideas that some of us have been working on. What would you support?

Mr. SHANE. The reason that I am doing this dance, Senator, is that we are in the middle of a formal rulemaking, and it is really not ethical for me to——

Senator KASTEN. But you have been dancing since 1988, September 1988. That is a long dance——

Senator FORD. And your partner is getting tired.

Senator KASTEN. Your partner is getting frustrated.

Mr. SHANE. I danced right into that one.

Senator KASTEN. Mr. Chairman, we are going to have to do something, I believe, on our own, and it is going to be part of the options that I just outlined, and the Administration is going to say they do not want us to legislate what they should be regulating, and in the process we might make some mistakes, and maybe they could do better.

But I think we are going to open up these slots to the limited incumbents, the new entrants, because the essence of competition is the ability to enter into competition, even at the tremendous disadvantages that a small airline has coming into a large market.

I mean, you talk about the disadvantage of having only four or six flights out of a given city, and think about trying to advertise that flight and all the other kinds of disadvantages. Even with those disadvantages, these people ought to have the opportunity to compete, if you are talking about a so-called deregulated environment. This is not a deregulated environment if there are limits to entrants.

Thank you, Mr. Chairman.

Senator FORD. Senator Danforth?

Senator DANFORTH. Mr. Shane, you do not contend that S. 1741 is an effort to reregulate airlines, do you?

Mr. SHANE. No, sir.

Senator DANFORTH. Then why did you say in your testimony, "any effort to reregulate would do more harm than good?"

Mr. SHANE. Because we have seen a number of other proposals, Senator, which are to reregulate the airline industry.

Senator DANFORTH. You are not here to testify about any other proposal. You are here to testify about S. 1741, and my concern is that you attempted to set up a straw man by, in effect, characterizing this as reregulation.

Mr. SHANE. Well, I apologize if that was the implication. I have had some questions this afternoon about the Economic Policy Institute study, and it was really that study and the reregulatory proposals in that study that I had in mind. I am sorry if there was a misunderstanding.

Senator DANFORTH. Do you think that deregulation works at Lambert?

Mr. SHANE. The reason I am hesitating is that I just do not have before me a very clear picture of the situation at Lambert. I certainly understand that Lambert is dominated by a single airline. I just do not have the actual fare experience and frequency experience right in front of me.

Senator DANFORTH. Okay. Well, could you furnish the Committee with the Department's position on whether deregulation works at Lambert?

Mr. SHANE. We would be happy to. It is right in our study.

[The following information was subsequently received for the record:]

As a broad generalization our study shows that air service today is superior to service provided before deregulation, and that the proliferation of hub and spoke systems has intensified the benefits of competition for the vast majority of travelers. We believe that these general findings apply to Lambert Field at St. Louis. Specifically, at St. Louis:

-- A comparison of current schedules with those in effect at the time of airline deregulation shows that the number of nonstop markets are up 36 percent (from 73 to 99 points) and the number of nonstop frequencies to St. Louis are up 67 percent (from 330 a day to 551 a day).

-- Currently, 81 of the 99 communities that receive nonstop service to St. Louis (82 percent) receive three or more round trip flights per day. In 1979, only about one-half as many communities (46) had three or more round trips per day. (Three round trips a day is generally considered a minimal service pattern for providing convenient service.)

-- Comparing current nonstop service with that of 1979 shows that 5 communities lost service while 31 gained service to St. Louis. In addition, comparing communities that were served both in 1979 and currently, three times as many now have an increase in the number of nonstop flights as show decreases.

Much of the concern about service and fares at St. Louis is the result of TWA's acquisition of Ozark. Comparing service before and after the merger suggests that St. Louis has benefitted. Although service changes vary from market to market, in general, TWA provides fewer frequencies in markets where both TWA and Ozark provided nonstop service in 1986, but TWA has increased service in other markets. This reflects a management decision to reduce redundant service in markets where TWA once competed with Ozark and to shift those resources to other markets. Also, while the total amount of service provided by other carriers has remained relatively stable, there have been competitive responses by other carriers in individual markets. This shows that other carriers are still willing and able to enter St. Louis markets despite TWA's dominant position. Every major carrier provides multiple daily operations to St. Louis to their respective hubbing centers, thus providing St. Louis passengers with alternatives to TWA's service.

Service between St. Louis and small communities has remained good subsequent to TWA's acquisition of Ozark. The number of non-hub and small hub airports receiving service to St. Louis has increased and 80 percent of these markets that receive monopoly service to St. Louis also receive competitive service to other carriers' connecting hubs.

Traffic response is perhaps the best gauge of TWA's service. Between 1984 and 1988 the number of passengers traveling to and from St. Louis increased by about 30 percent. This high traffic growth clearly suggests that St. Louis travelers are receiving excellent service.

The fare experience at St. Louis has also been generally favorable. Between 1984 and 1988 average fares declined in three of the top five St. Louis markets and, overall, local St. Louis fares (unadjusted for inflation) were up by just 1.3 percent for the entire four-year period. This is consistent with the experience of other large hubs which as a group showed a 1.4 percent increase during this same period. While on average, 1988 fares at St. Louis were about 18 percent higher than fares in other markets of similar size and density, this represents little change from 1984 when the average fare premium was 16 percent. The fact that the premium is virtually the same as it was before St. Louis became more concentrated, suggests that concentration stemming from the TWA acquisition of Ozark, is not the cause of higher average fares at St. Louis. In any event, the tremendous traffic growth at St. Louis during the past four years is evidence that the combination of fares and greatly improved service brought about by deregulation has been a very positive development for St. Louis travelers.

Our study did find that gate availability at St. Louis is a problem. A 1989 survey by the Airport Operations Council International (AOCI) was used as our data source. The survey response by Lambert Field officials indicated that no gate could be quickly made available to a new carrier for peak hour service, and, in fact, none could even be provided in 6 months. In other words, the 76 gates at Lambert are fully utilized at the times passengers prefer to travel. We believe addressing this type of bottleneck is the best approach to improving competitive conditions in the industry. That is why the Secretary has requested that more funds be made available for airport expansion projects through the local use of passenger facility charges (PFC'S) and an increase in the federal ticket tax. St. Louis is currently developing a master plan to bring the total number of gates at Lambert up to 100.

Senator DANFORTH. Is it the view of the Department that slots are a private asset or a public asset?

Mr. SHANE. The slots in the first instance to be sure are a public asset. What we have had in place for a while is a rule that allows transactions to take place in that public asset which, therefore, allows them to take on some of the qualities of a private asset. We do not acknowledge that they are so purely a private asset that some of the suggestions that, for example, Senator Kasten has made today, are beyond reach. It is a bit of a hybrid at the moment.

Senator DANFORTH. How about international routes? Are they hybrids, or are they public assets or private assets?

Mr. SHANE. They are hybrids very much in the same way, Senator. They come free of charge to the first incumbent. That is, the U.S. Government gives an airline a piece of paper after establishing a bilateral agreement with a foreign government, and that piece of paper is a license to fly an international route.

What happens with that piece of paper is typically that the airline invests a lot of money establishing a presence, establishing goodwill, establishing a market, if you will, such that some real asset value obtains. And the CAB, before the Department of Transportation, and now the Department of Transportation have approved transactions in which those so-called franchises, as long as it was consistent with the public interest, were transferred for consideration from one airline to another.

Senator DANFORTH. Do you think that it is right that airlines should be able to borrow against slots and borrow against international routes, use them as collateral?

Mr. SHANE. I do not think it is right, no, sir.

Senator DANFORTH. Do you think it is right that they should be able to sell slots for cash, or sell slots, or sell international routes for cash?

Mr. SHANE. The rule currently allows that to happen.

Senator DANFORTH. Do you think that is right?

Mr. SHANE. I think the rule is right right now, but whether or not——

Senator DANFORTH. How can that be? How can the Government confer a free benefit based on the public interest and then have this turned into just a commercial item that is bought and sold?

Mr. SHANE. Well, the issue is, is there a better mechanism for a proper allocation?

Senator DANFORTH. The issue is not is there a better mechanism. The issue is, how can it be that something that is a public right that is conferred by the Federal Government with no consideration flowing to the Government can turn into an asset which is bought, sold, borrowed against, and listed as an asset on a balance sheet?

Mr. SHANE. We are talking right now within the Department of Transportation—in fact, the airport operator community generally is talking about the possible privatization of a lot of airports, airports that were created as public entities, in many cases were created by government entities with no cost to any private party.

All of a sudden it may very well be that a private party comes in and begins to obtain real profits from what had been a public asset. There has to be—at some point, if you are shifting to a market-

based approach to some of these heretofore public sector activities, there has to be a transitional process.

At some point, somebody gets something that used to be a public asset and it is always possible to have a debate about whether or not there was full or just consideration for that. But the fact is, it is sometimes necessary to simply bite the bullet and say we are moving to a market-based approach to the allocation of these assets, and we realize that there may be something like some unjust enrichment here by the usual meaning of that term. If the result is that you have a more efficient allocation of scarce resources, then maybe that is a bullet worth biting.

Senator DANFORTH. Well, it just would seem to me to be absolutely clear that slots are a public asset, that international routes are a public asset, that they are distributed in such a way as to be beneficial to the traveling public, and that they are not distributed for any other reason.

Then to somehow have the whole concept, the decision that they are no longer just public interest, that are distributed for the public good, but that they can be bought, sold, borrowed against and listed on balance sheets, that is just absolutely wrong, as a matter of concept and policy. I am amazed that the Administration does not take that position.

Mr. SHANE. There have been discussions. I am not suggesting that this is an Administration proposal, but there have been discussions about whether or not one could start a system in which foreign routes for U.S. carriers were sold by the U.S. Government, recognizing that it is a Government asset in the first instance—just auctioning them off the way you would auction off surplus Government property.

Then I presume that there would not be any philosophical problem with them being transferred for consideration in the secondary market. Well, we have not adopted the auction mechanism for distributing international routes, but we have said that if it looks as though the public interest might be served by a private transaction which, number one, puts a stronger competitor on an international route and, number two, brings a cash infusion to a carrier that needs it, thereby preserving a competitor in the market then maybe the U.S. Government should not get in the way of that. I think that is consistent with good sense.

Senator DANFORTH. Well, I am doubtful. Let me ask you about code-sharing. Is not code-sharing a deceptive business practice?

Mr. SHANE. It could be.

Senator DANFORTH. Is it not necessarily and always a deceptive business practice?

Mr. SHANE. It will only be deceptive if people are deceived. And if the rules require full disclosure of the fact that you are moving from one carrier to another, albeit under the same code, then it is not deceptive.

Senator DANFORTH. Do you think the travel agents are informed?

Mr. SHANE. Travel agents are certainly informed.

Senator DANFORTH. Really?

Mr. SHANE. They must be informed, or somebody is violating a Department of Transportation rule.

Senator DANFORTH. How are they informed when they are using a computer, and I call up a travel agent and say that I want to fly from Washington to Columbia, Missouri? Is the travel agent informed that this is not in fact going to be TWA all the way?

Mr. SHANE. Yes, indeed. If the travel agent is using a computer reservation system then the CRS display will have an asterisk or some other signal next to the code-shared flight which is meant to tip them off that this is not TWA, this is a code-sharing partner, and they are required to tell you that as well.

Senator DANFORTH. The public knows that?

Mr. SHANE. The travel agent is required to disclose that to the traveling public, yes, sir.

Senator DANFORTH. Okay. What good does it do to have code-sharing?

Mr. SHANE. What we have found is that it has enabled a lot of smaller communities to get far more convenient service than appeared to be the case before the code-sharing device was established. We have seen it both domestically and internationally. Internationally, we have had a lot of foreign carriers come in and ask for the ability to code-share with a domestic carrier, thereby giving them much better access under their own name to internal communities within the United States.

What that means is that those communities get one-stop, direct, widely advertised service to a foreign capital, and that is bread and butter to that community. Domestically, the same phenomenon takes place.

Senator DANFORTH. I do not understand the phenomenon. What happens with code-sharing? What good does it do?

Mr. SHANE. The foreign carrier is looking for a way of establishing a presence at a small community which it cannot serve with its own aircraft because the economics simply do not justify sending their Boeing 747.

Senator DANFORTH. How does code-sharing help them?

Mr. SHANE. What they can do by code-sharing is once they have the authority from the United States Government, advertise service to that smaller community under its own name, and what they do is——

Senator DANFORTH. Is that not deceptive?

Mr. SHANE. Again, the consumer must be informed of the nature of the service according to Department of Transportation rules.

Senator DANFORTH. Are they told that this is, say, TWA flying to Columbia, or are they told something else?

Mr. SHANE. When they purchase the tickets, they must be told something else. If they are not told something else, somebody is violating the rule.

Senator DANFORTH. Then why have code-sharing? What good does it do them? Either code-sharing does something, or it does not. Now, you are telling me that there is no—your explanation of why it is not deceptive is that nobody is deceived and that everybody knows that TW does not mean TW. In that case, why not just abolish it as being totally useless and not doing any good at all?

Mr. SHANE. Typically, the code-sharing relationships that we have seen involve not just the use of somebody else's code, they involve a coordination of schedules, usually a coordination of gates, a

coordination of services such that the traveling public is being given, in fact, objectively speaking, a more convenient service by virtue of——

Senator DANFORTH. Those are called inter-line agreements, are they not?

Mr. SHANE. Inter-line agreements do not have all of the elements built into a typical code-sharing agreement. A code-sharing agreement represents a joint venture partnership that is meant to be of a higher quality in terms of the service provided to the public.

Senator DANFORTH. Can that not be provided for by inter-line agreements without code-sharing?

Mr. SHANE. I suppose it could be, but the incentive to do that is much less because the airline is not able to serve that final destination under its own code.

Senator DANFORTH. You and I are talking. I do not understand your position. You are taking two positions at the same time. You are saying first of all, it is not deceptive because everybody knows it is not the same airline. Secondly, you are saying that the whole incentive to the airline is that everybody thinks that they are flying on the same airline. Now, which way do you want it?

Mr. SHANE. Marketing is a subtle business, and the idea is to get the passenger to call up the airline that is offering the direct service. If the passenger, after being informed of the nature of the service, chooses to go somewhere else, that is the passenger's right, but the point is that we are offering communities in the United States much better service both to major hubs and to major foreign destinations by virtue of code-sharing than they could have gotten otherwise.

Senator DANFORTH. No, we are not. You explain to me how we are.

Mr. SHANE. When United flies from Seattle to Chicago it picks up a passenger that is left in Chicago by British Airways. It picks up that passenger. The passenger has a ticket that says he is flying to Seattle under a British Airways code. I think they also have a code-share to Denver now, as well.

British Airways is able to establish a flight into Seattle which Seattle is delighted to have, and the only difference is that the passenger is actually hooking up on United. The passenger is carrying that British Airways ticket on United Airlines from Chicago to Seattle, and the net result is that Seattle has——

Senator DANFORTH. What does that have to do with code-sharing?

Mr. SHANE. It is a code-shared flight, sir. The passenger is flying what is called a code-shared service from London to Seattle.

Senator DANFORTH. The passenger is flying two different airlines, right?

Mr. SHANE. Correct.

Senator DANFORTH. What does it say on the computer screen?

Mr. SHANE. It says it is flying on a British Airways code with a connection to United Airlines at Chicago.

Senator DANFORTH. Does it say that on the screen?

Mr. SHANE. In code, yes, sir.

Senator DANFORTH. Code-sharing means that it says that it is flying British Airlines all the way, does it not?

Mr. SHANE. The ticket will say "British Airways." When the purchase is made, when the passenger deals with the travel agent, the travel agent is specifically required to say to the customer, you will be picking up United Airlines at Chicago. United Airlines is operating the remainder of the British Airways flight.

Senator DANFORTH. So you are saying there is no deception?

Mr. SHANE. If people are playing by the rules, there is no deception.

Senator DANFORTH. Do you think that deception is built into the system if they both say TWA—TW? You go to the ticket agent, you say, "I want to fly from here to Columbia," and the code says "TW and it flies." It is supposed to fly all the way to Columbia and in fact it flies to St. Louis and then you have to get on Resort Air at St. Louis, a little plane with one seat on each side of the aisle. You do not think that is deceptive?

Mr. SHANE. Again, if the travel agent is playing according to the rules, the passenger is meant to be informed of precisely what is going on.

Senator DANFORTH. Well, it seems to me that one of two things is happening. Either code-sharing is of absolutely no consequence, because everybody is informed and therefore we may as well do away with it, or in the alternative code-sharing does create a competitive advantage for somebody and therefore it is deceptive. Which way do you think it is?

Mr. SHANE. Well, I think it is a third way, with all respect. If in fact they are providing a better service by virtue of coordinated schedules and coordinated baggage handling and coordinated gates, then it is not just another inter-line service. They are describing a superior inter-line service through a code-share in a way that signals to the passenger that there is something going on here that is not going on in the garden-variety inter-line connection.

What I am concerned about is that if we outlaw code-sharing altogether, the airlines will figure out a better way to do it, which is to simply buy those code-sharing partners, and we have seen enough of that go on already. That would not be good for competition.

Senator DANFORTH. Do you think code-sharing creates a competitive advantage for the major airline that uses the commuter airline? Is it a competitive advantage for, say, TWA to have code-sharing with Resort?

Mr. SHANE. It is designed to create a more attractive service. Whether it is a competitive advantage that requires Government intervention is not clear to me, but it is——

Senator DANFORTH. Do you think that it creates a competitive advantage? You are against Government intervention, you are against the whole bill. But do you think it creates a competitive advantage?

Mr. SHANE. I am not against the whole bill, number one.

Senator DANFORTH. What are you for?

Mr. SHANE. PFCs, except we would like bigger PFCs.

Senator DANFORTH. You would like your own PFCs. Okay. I repeat, you are against the bill—against the whole bill.

Do you think that this creates a competitive advantage for TWA?

Mr. SHANE. Yes.

Senator DANFORTH. Does it create a competitive advantage for Resort Air?

Mr. SHANE. As the code-sharing partner?

Senator DANFORTH. Yes.

Mr. SHANE. To be sure.

Senator DANFORTH. Therefore, a disadvantage against competitors with TWA?

Mr. SHANE. Well, they have the option, I suppose, of finding their own code-sharing partners and offering a competitive service.

Senator DANFORTH. Obviously, if it creates a competitive advantage for TWA it creates a disadvantage for somebody else, right?

Mr. SHANE. The market is based on people trying to obtain competitive advantages.

Senator DANFORTH. Does it create a competitive disadvantage for competitors of TWA?

Mr. SHANE. If they have not had the wherewithal to establish code-sharing arrangements with other code-sharing partners, it would be putting them at a competitive disadvantage, to be sure.

Senator DANFORTH. The same is true for competitors of Resort Air?

Mr. SHANE. I am sure that is the case.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. Thank you, Senator Danforth.

Let me ask you one final question. In putting your study together, what facets of the industry did you discuss this with in order to complete your study.

Mr. SHANE. To what extent do we go out to the industry itself? Is that your question, Mr. Chairman?

Senator FORD. When you say the industry itself, are you just talking about airlines?

Mr. SHANE. Yes. I am trying to understand the question.

Senator FORD. You talked about the study in your statement. A lot of work and thought went into it, obviously, and the sponsors are to be commended for focusing national attention on this critical issue.

You know, Secretary Skinner had similar concerns last year and asked his staff to undertake a comprehensive assessment of the state of competition in the domestic airline industry.

Did you just go to airlines?

Mr. SHANE. No, sir, we did not go to airlines. On the contrary——

Senator FORD. You went to no airlines? You did not talk to the airlines?

Mr. SHANE. We did not talk to the airlines.

Senator FORD. Who did you talk to?

Mr. SHANE. The study was performed by Department of Transportation staff working in concert with a collection of other agencies of government.

Senator FORD. You did not go out and talk to airport operators, the executives, airlines? You did not bring FAA in or anything like that?

Mr. SHANE. We took advantage of a survey that the AOCI had done of the availability of gates as one aspect of the study where we looked at the airport impediments to competition.

STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY JACK WELLS; AND FRANK MULVEY

Mr. MEAD. Mr. Chairman, we always learn a lot when we come before this subcommittee.

Senator FORD. Is it not fun?

Mr. MEAD. Especially as the second witness.

Senator FORD. We got it all out with the first one, I think.

Mr. Mead, you have been here before, and we have enjoyed your testimony and help and your frankness. So we are very pleased to have you today, and you may proceed. You can hopefully highlight.

Mr. MEAD. Mr. Chairman and Senators McCain and Kasten, I would like to introduce my colleagues at the table, Jack Wells on my left and Frank Mulvey on my right. They have been with our airline competition work since its inception several years ago.

I would like to greatly summarize the prepared statement and just touch on the highlights.

Senator MCCAIN. I think I summarized it for you.

Mr. MEAD. I think you did an excellent job.

First, fares. I would like to provide an update from where we were last time when we testified before the subcommittee. We have updated our prior analysis up through the first half of 1989. We found that the gap between the fares at the 15 concentrated airports we reviewed and the other unconcentrated airports persisted and remained in the neighborhood of 26 or 27 percent.

We adjusted for distance and found that even after the adjustment for distance it is still about 21 percent higher.

DOT, as Mr. Shane has just testified, found an 18 percent difference. The difference between our estimate and DOT's is probably attributable to the fact that in their analysis they counted flights terminating at the concentrated airports as well as those originating.

We counted only those originating traffic because we were interested mostly in the fares people must pay who live in the community where the concentrated airport is located.

Part of our evaluation, and the one that Senator McCain summarized earlier for me, focused on an effort to estimate the relationships between each of the airline operating and marketing practices that potentially are barriers to entry and airline fares. We did this through an econometric model which uses statistical techniques that allow us to measure the effects on fares from changes in one variable when other variables are held constant.

This was a fairly significant production for us. We looked at over 1,600 routes, and we gathered original survey data on airport gates, leasing agreements, noise restrictions, and expansion plans for 183 airports. We also did a survey of over 500 travel agents on the effects of airline marketing practices.

I want to stress that our findings are preliminary, and while an econometric model will never be able to establish or prove cause and effect, we believe the model does allow us to make some systemwide observations. Senator McCain touched on those earlier, and I would like to reiterate them now for the record.

STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY JACK WELLS; AND FRANK MULVEY

Mr. MEAD. Mr. Chairman, we always learn a lot when we come before this subcommittee.

Senator FORD. Is it not fun?

Mr. MEAD. Especially as the second witness.

Senator FORD. We got it all out with the first one, I think.

Mr. Mead, you have been here before, and we have enjoyed your testimony and help and your frankness. So we are very pleased to have you today, and you may proceed. You can hopefully highlight.

Mr. MEAD. Mr. Chairman and Senators McCain and Kasten, I would like to introduce my colleagues at the table, Jack Wells on my left and Frank Mulvey on my right. They have been with our airline competition work since its inception several years ago.

I would like to greatly summarize the prepared statement and just touch on the highlights.

Senator MCCAIN. I think I summarized it for you.

Mr. MEAD. I think you did an excellent job.

First, fares. I would like to provide an update from where we were last time when we testified before the subcommittee. We have updated our prior analysis up through the first half of 1989. We found that the gap between the fares at the 15 concentrated airports we reviewed and the other unconcentrated airports persisted and remained in the neighborhood of 26 or 27 percent.

We adjusted for distance and found that even after the adjustment for distance it is still about 21 percent higher.

DOT, as Mr. Shane has just testified, found an 18 percent difference. The difference between our estimate and DOT's is probably attributable to the fact that in their analysis they counted flights terminating at the concentrated airports as well as those originating.

We counted only those originating traffic because we were interested mostly in the fares people must pay who live in the community where the concentrated airport is located.

Part of our evaluation, and the one that Senator McCain summarized earlier for me, focused on an effort to estimate the relationships between each of the airline operating and marketing practices that potentially are barriers to entry and airline fares. We did this through an econometric model which uses statistical techniques that allow us to measure the effects on fares from changes in one variable when other variables are held constant.

This was a fairly significant production for us. We looked at over 1,600 routes, and we gathered original survey data on airport gates, leasing agreements, noise restrictions, and expansion plans for 183 airports. We also did a survey of over 500 travel agents on the effects of airline marketing practices.

I want to stress that our findings are preliminary, and while an econometric model will never be able to establish or prove cause and effect, we believe the model does allow us to make some systemwide observations. Senator McCain touched on those earlier, and I would like to reiterate them now for the record.

First, the larger the share of gates that a carrier leased on a long-term exclusive use basis, the higher its fares were at the airport. Also, flights at airports where entry was limited by slot controls had average air fares about 7 percent higher.

Where runway capacity was constrained and expansion influenced by the presence of the majority-in-interest clause, air fares, on average, were about 3 percent higher.

We did not find that noise restrictions were consistently related to higher fares.

We found that the larger an airline's share of the computerized reservation system market in an area, the larger its market share on routes in that area; and the more travel agents to whom a carrier paid commission overrides in a market, as distinguished from just the regular commission, the higher the carrier's fares tended to be.

With regard to code-sharing, carriers with a code-sharing agreement at one of the airports on a route charged fares that were nearly 8 percent higher than carriers on routes on which there were no code-sharing agreements.

For frequent flyer plans, we were not able unfortunately to measure their impact. That is due largely to the fact that making such an estimate would require access to proprietary data. We do not have that type of access and, therefore, cannot make a definitive estimate.

We did, though, survey over 500 travel agents, and they said that their business customers choose their flights on the basis of frequent flyer plans at least half the time. Our analysis of the structure of frequent flyer plans indicates that the dominant carrier in a market will have a powerful advantage in attracting airline passengers to use its plan.

I would like to turn to policy considerations and discuss not just the bill but a policy approach in general. On the basis of our work, we have some observations here that the committee might productively consider. It seems to us there are several approaches to resolving the problems we have identified. One approach is to focus directly on the high share of enplanements that carriers have at an airport. For example, the Congress could conceivably say that you cannot have more than a 70 percent share of enplanements at a particular airport.

We have reservations about that approach. The actual market power that a carrier will wield depends not just on the share of enplanements but on the number of gates the carrier controls—particularly under the exclusive lease arrangement—CRSs, frequent flyer plans, and various other factors.

So in general, we think it would be more effective to address the particular sources of market power rather than the number of enplanements.

A second approach is to expand airport capacity, and we included in our model a variable that would measure the effects of limited capacity. It is true, as the Department of Transportation study points out, that this is a big barrier to entry. It showed up in our model as being a significant determinant of higher fares.

However, there are two problems with relying exclusively on the airport expansion approach. The first is that some of the competi-

tive problems, such as the share of gates that an airline leases exclusively, have nothing to do with, and will not be addressed by, an expansion.

Second, and in some ways more important, airport expansion takes a long time. There is a lot of talk about airport expansion and new airports and wayports and so forth, but they may be a long time coming.

If over the next couple of years we lose another two or three carriers and these ambitious airport expansion plans and airspace expansion plans do not materialize, it will be much more difficult and complex to inject competition in the market. There are already some suggestions that in some of the concentrated markets fare caps should be imposed. While we think that is premature, we cannot say what policy choices you will be faced with two or three years down the road if you do not act now.

A third approach would focus on adopting a range of policy options to address airline competition problems by dealing with specific entry barriers. Our work, particularly our model, suggests that a range of factors or barriers interact to produce the higher fares that we have observed, so that acting on just one of the barriers to entry will not solve all the problems.

We suggested in our last appearance before this subcommittee a number of policy options for the Congress to consider. Several of these options are incorporated in S. 1741. I think the principal concern we would have with S. 1741 is that at a certain market share you are presumed to be anticompetitive, and we have reservations about dealing with the problem that way.

Beyond that, there are a number of options in the bill that we think can usefully be considered. Policies like requiring the use of use-or-lose leases or preferential-use leases should be considered. A method of reallocating airport slots is also urgently needed.

We have also suggested various ways of reducing airport reliance on airlines for financing and for addressing the competitive problems posed by computerized reservation systems. I have not enumerated all those in our testimony because we have done that before, but I would be glad to go over them in the question and answer period if you like.

That concludes our prepared statement, Senator.

[The statement follows:]

STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GAO

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on the work we are doing at your request on the effects of airline market concentration and barriers to entry on airline fares. We testified before this Committee last June on our analysis of the effects of airport concentration an airline fares.[1] We testified again last September on the extent of barriers to entry in the airline industry.[2] Since that time, the Department of Transportation has issued its report of the Secretary's Task Force on Competition in the U.S. Domestic Airline Industry. Our testimony today will (1) update our June 1989 analysis of airline pricing and compare our results to those of the Secretary's Task Force, (2) report on the preliminary results of our econometric analysis of the effect of barriers to entry on airline fares, and (3) discuss the implications of our findings for policymaking.

Last June, we testified that airline yields, or fares per passenger-mile, at 15 concentrated airports in 1988 were 27 percent higher than at 38 unconcentrated airports.[3] We have updated our data through the second quarter of 1989, and find that the gap persists. It is now 26 percent. The DOT report reached conclusions very similar to ours. After adjusting for differences in flight distance between concentrated and unconcentrated airports, both studies found yields at concentrated airports around 20 percent higher than at other airports (DOT's estimate was 18.4 percent; ours was 21.0 percent). The Task Force also reviewed a number of the entry barriers that we discussed in our September

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[1] Air Fares and Service at Concentrated Airports (GAO/T-RCED-89-37, June 7, 1989).

[2] Barriers to Competition in the Airline Industry (GAO/T-RCED-89-65, Sept. 20, 1989).

[3] GAO considered an airport market concentrated if one airline handled 60 percent of the enplanements or if two airlines handled 85 percent.

testimony and found, as we had, that several of them have the potential to significantly limit entry into airline markets.

We are currently estimating the relationships between fares and the various operating and marketing practices that may discourage entry. Our analysis to date indicates that many of the airline operating and marketing practices we have discussed are in fact related in a statistically significant way to higher airline fares. Our results suggest that no single factor is responsible for higher fares at concentrated airports, but that it is the interaction of a number of barriers that allows carriers at these airports to charge higher fares.

We recognize that various solutions have been proposed for dealing with the factors that limit competition in the airline industry, including limiting concentrated hub airports and increasing airport capacity. We have reservations about presuming all concentrated hubs to be anticompetitive. We agree that increasing capacity would be helpful, but we are concerned that increasing capacity will take too long, and that increases in capacity alone will not solve all the problems of competitiveness that we have identified. Along with initiatives to enhance airport capacity, we believe that a broad range of policy options to reduce the anticompetitive effects of various industry operating and marketing practices, such as those we have discussed in our previous testimony, should be considered.

FARES AT CONCENTRATED AIRPORTS

Yields at the 15 concentrated airports rose in 1989, from 18.5 cents per passenger-mile in 1988 to 21.0 cents in the first two quarters of 1989. Yields at the 38 unconcentrated airports also rose, from 14.5 cents to 16.7 cents, leaving a gap between the yields at concentrated and unconcentrated airports of 26.4 percent. The dominant airline's yields rose particularly rapidly at Detroit,

Raleigh-Durham, Greensboro, Pittsburgh, Syracuse, and Denver. When compared to the yields at 22 unconcentrated airports where average trip distance was about the same as at the concentrated airports, yields at concentrated airports were 20.7 percent higher in the first half of 1989. Airline travel from the 15 concentrated airports represents 21.8 percent of all airline revenue passenger miles. Concentrated airports that did not meet other criteria of our study accounted for another 9.5 percent of airline traffic.[4]

In February, the Secretary of Transportation released the report of his Task Force on Competition in the U.S. Domestic Airline Industry. The report discussed changes in market structure, pricing, and barriers to entry since the airline industry was deregulated in 1978. The report concluded that air fares (in constant dollars) have fallen since 1979 but that, as our work has shown, air fares are higher at concentrated airports than at unconcentrated airports.

Our analysis of the higher yields at concentrated airports and the Task Force's analysis are similar. The Task Force found that fares at the 15 concentrated airports, after adjustment for variations in flight distance, were 18.4 percent higher than at airports generally. We found, after also adjusting for flight distance, that yields at the concentrated airports were 21.0 percent higher than at unconcentrated airports. The remaining difference may be due to the fact that DOT's study examined passengers both originating and terminating their trips at the concentrated airport, while we looked only at passengers originating there.

The Task Force also came to conclusions similar to ours concerning a number of the entry barriers we have examined. The

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[4]One of these airports was outside the 48 contiguous states; the others were in cities with multiple airports.

Task Force found that new entrants are likely to pay higher lease rates at airports with exclusive-use leases, where the entrant must sublease space from incumbent carriers. The Task Force also found that majority-in-interest and other clauses that limit expansion at airports may discourage new entry.[5] It did not find that slots are, by themselves, an entry barrier.[6] However, it concluded that there is the potential for the exercise of market power in the market for slots, and therefore that the slot rule had the potential to result in an entry barrier. The Task Force concluded that noise restrictions are not now a major barrier to entry, but that they could become a barrier if noise restrictions proliferate.

In reviewing airline marketing strategies, the Task Force found that frequent flyer plans may make it more difficult for smaller air carriers to compete successfully in some markets; that computerized reservation systems (CRSs) may transfer $2 billion to $3 billion in gross revenues to CRS vendors; that travel agent commission overrides weaken the competitive position of smaller carriers; and that new entrants have difficulty competing with code-sharing regional airlines on hub-to-spoke routes.[7]

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[5]A majority-in-interest clause (MII) in an airport use agreement gives the carriers performing a majority of the operations at the airport authority to disapprove expansions of the airport that would be paid for through fees charged to those airlines.

[6]The Federal Aviation Administration restricts landings and take-offs at four congested airports (Washington National, New York LaGuardia and Kennedy, and Chicago O'Hare). Carriers wishing to serve these airports must secure a reservation, or "slot," at the airport to use the airport regularly at a particular hour each day.

[7]Code-sharing agreements are agreements between jet airlines and commuter airlines in which the commuter airline agrees to share the two-letter designator code of the jet airline, so that both airline's flights are booked as if they were the same airline. The commuter airline also generally paints its planes in the colors of the jet airline and coordinates schedules so as to enhance the convenience of connections.

ANALYSIS OF RELATIONSHIP BETWEEN AIRLINE OPERATING AND MARKETING PRACTICES AND FARES

Part of our investigation has been an effort to estimate the relationship between each of these airline operating and marketing practices and airline fares, using an econometric model of airline industry pricing. We would expect that factors that discourage entry would generally tend to raise fares. We wanted to find out which factors were related to higher fares, either directly or through their effect on market share. An econometric model uses statistical techniques to analyze the relationships between airline fares and a large number of other factors. These techniques allow us to measure the effects on fares of changes in one variable when other variables are held constant.

Our model incorporates various factors that influence fares, including cost factors such as flight distance and traffic volume; demand factors, such as income levels and consumer preferences for different airlines; market structure factors, such as market share and concentration indexes; as well as several factors representing airline operating and marketing practices that may function as entry barriers. We analyzed 1988 DOT data on airline fares, traffic levels, and enplanements for over 1600 routes. We also gathered original survey data on airport gates, leasing agreements, noise restrictions, and expansion plans for the 183 airports covered by the analysis. Our analysis thus covers the effects of entry barriers at both concentrated and unconcentrated airports. We analyzed the effects of these factors on both fares and market shares.

While our findings are preliminary and subject to change, and while an econometric model cannot prove that a factor causes higher prices, we believe that the model allows us to make system-wide observations of the relationships between various airline operating and marketing practices and airline fares and market shares.

Our analysis to date indicates that many of the airline operating and marketing practices we have discussed are in fact related in a statistically significant way to airline fares. In particular, our results indicate the following:

-- The larger the share of gates a carrier leased at an airport, especially if those gates were on long-term exclusive-use leases, the higher its fares were at that airport (for example, a doubling of a carrier's gate share is associated with an increase in fares on a route of, on average, 3.5 percent).

-- Flights at airports where a majority-in-interest clause might reduce the ability of the airport to expand had, on average, about 3 percent higher air fares.

-- Flights at airports where entry was limited by slot controls had, on average, about 7 percent higher air fares.

-- If the runway capacity of the airport is congested, and expansion is limited by the presence of a majority-in-interest clause or other problems, fares are, on average, about 3 percent higher.

-- noise restrictions were not consistently related to higher fares at airports where they were in effect;

-- the larger an airline's share of the computerized reservation system market in a metropolitan area, the larger its market share on routes from airports in that area, though the amount of the increase varied with different versions of the model;

-- The more travel agents to whom a carrier paid commission

overrides in a metropolitan area, the higher the carrier's fares tended to be on service in that area, though the size of this effect also varied with different versions of the model.

-- Carriers with a code-sharing agreement at one of the airports on a route charged fares almost 8 percent higher than carriers did on routes on which they did not have code-sharing agreements.

Though these magnitudes represent our best estimates to date, these results are preliminary, and the relative effects of some specific industry practices may change somewhat as our analysis is completed. We were not able to develop any measure of the impact of frequent flyer plans on airline fares in particular markets because the data needed to measure the impact of frequent flyer programs on a particular route are proprietary. However, we have recently completed a survey of 522 travel agents and found that the business customers of more than 80 percent of travel agents nationally choose their flights on the basis of frequent flyer plans at least half the time.[8] Our analysis of the structure of frequent flyer plans indicates that the dominant carrier in a market will have a powerful advantage in attracting airline passengers to use its plan.

POLICY IMPLICATIONS

There are several approaches to dealing with problems of competition in the airline industry. One approach is to focus directly on the high shares of enplanements that carriers have at some airports, which we found were associated with higher fares. For example, the Congress could limit the number of airports at

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[8]The 95-percent confidence interval on this percentage is ± approximately 4 percent.

which enplanements exceed a particular level. We have reservations about this approach, however. The actual market power that a carrier wields depends not just on its share of enplanements, but on the number of gates the carrier controls, the terms on which it controls those gates, and the extent to which expansion of the airport is limited by majority-in-interest clauses or other factors. We found in our airport survey that 85 percent of all gates at the 66 large and medium airports are leased on an exclusive-use basis. The market power of a dominant airline is also affected by its use of various marketing strategies, such as CRSs and frequent flyer plans. In general, we believe that it is more effective to address these sources of market power than to assume that any particular level of enplanements is anticompetitive.

A second approach is to expand the capacity of existing airports and to build new ones. We certainly agree that, in the long run, expansion of capacity is the best way to ensure that carriers can easily establish service at any airport. We included in our model a variable to measure airport congestion, and found that it was significantly related to higher fares. However, there are two significant problems with relying exclusively on this approach. First, our model makes clear that other factors were significantly related to fares as well, such as shares of gates leased. Second, airport expansion takes time. Disagreements about where airports should be located and how they should be financed can be expected to continue to delay airport expansion. If airport expansion cannot be achieved in the near term, and if two or three more carriers go bankrupt, competition could be reduced to the point that it would be much more difficult and complex to inject new competition in the industry. Already there are suggestions that fare caps be imposed. In our view, these proposals are premature; it would be more consistent with relying on market competition to take the comparatively modest steps required now to preserve competition where it is already vigorous and reverse the

erosion of competitive markets that has already occurred.

A third approach would focus on adopting a wide range of policy options to address airline competition problems related to specific entry barriers. Our econometric work suggests that a wide range of factors appear to interact to produce the higher fares we have observed, so the policy response to market power at concentrated airports should be broad-based, addressing several factors at once. We have suggested in our previous testimony a number of policy options for the Congress to consider. Several of these options are incorporated in S. 1741.

For example, policies that would make it easier for carriers to obtain access to gates at airports, perhaps by requiring the use of use-or-lose clauses or preferential-use leases, should be considered. Also, some method of re-allocating airport take-off and landing slots would help to open the four slot-controlled airports up to more competition from low-cost airlines. Our analysis found that fares tend to be lower in markets where low-cost airlines are competing. We have also suggested various ways of reducing the incremental airline revenues and excessive booking fees earned by CRS vendors.

This concludes my statement. I would be happy to answer any questions you may have.

Senator McCAIN. Thank you very much, Mr. Mead.

As Chairman Ford mentioned, we have heard from you on several occasions in the past, and we have found your findings to be critically helpful in our deliberations on these very complex issues.

You and DOT agree on a lot of the facts; yet, many of the conclusions seem to be somewhat different. For example, DOT says only 4 percent of the passengers must use concentrated hub airports with higher fares; yet, GAO says 21 percent of the travelers are affected.

Is there any way that you can account for that difference?

Mr. MEAD. Yes. Actually, there are several ways. You point out correctly that on the basic numbers there is no disagreement. The disagreement is on the conclusions that you might attach to the numbers.

For example, we concluded in our analysis that fares were higher at 15 concentrated airports. They considered eight. They also did not focus on routes originating out of the concentrated airports, they also included flights terminating at the concentrated airport cities. That might explain why their number is lower than ours.

As I pointed out in our statement, the reason we focused on just the originating traffic is because we wanted to see what happened to the people who lived in the city with the concentrated airport.

Senator McCAIN. I would like for you to be more specific about which provisions of the legislation that you think would help address this problem and those which do not. But let me just ask you one sort of a philosophical question.

Given all the trends that you have now studied for several years, mainly at the request of this committee, and your background and that of your staff assistants, what happens to the airline industry in America if we do nothing, if we simply rely on airport expansion, which obviously seems to be the recommendation that the Department of Transportation has come forward with?

Mr. MEAD. Senator McCain, your bill sets out a range of policy options now. There are some provisions in the bill with which we have reservations, and there are other provisions that we think are worth pursuing, and we will respond to that in the record.

We think some of those provisions would be quite effective in opening up already concentrated markets to more competition and to prevent the erosion of competition in markets that are currently competitive.

Two or three years down the road, those options that are now in the bill may no longer be viable. We are concerned that if we do not act in the near term and take these comparatively modest steps, you may be faced two years from now with fare caps and imposing price ceilings in markets that have become so concentrated that they are effective monopolies.

Senator McCAIN. We will have quite a few less airlines.

Mr. MEAD. Yes. That is a real concern.

Senator McCAIN. Thank you very much, Mr. Mead.

Senator Kasten.

Senator KASTEN. Mr. Mead, have you addressed the problem of limited entrance, limited incumbents and new entrants with regard to slots?

Mr. WELLS. Yes, we did. Slot controls are one of the factors that we looked at in our econometric analysis.

Senator KASTEN. In airports where slots were available as opposed to airports where slots were not available, did you see any significant difference in fares?

Mr. WELLS. We estimated a 7 percent fare difference between slot controlled airports and airports where there were no slot controls.

Senator KASTEN. Is there any recommendation that you would make, or you, Mr. Mead, would make, with regard to the problem? I do not know if you were here when I spoke earlier, but we are going to have to legislate this. The Department of Transportation is not responsive. I did not go through all of the choices.

Another option is to put all of the slots back up for auction, if you will.

What kinds of options do you think are most viable with regard to opening up slots for limited incumbents and new entrants?

Mr. MEAD. I will try to take a stab at part of that and then defer to Jack.

I think the threshold question that faces the committee is not whether to move on slots. Somebody has to move on the slot situation, and if it is not DOT it will have to be the Congress.

A question beyond that which needs to be resolved is whether you are going to charge for the slots or allocate them by lottery.

Senator KASTEN. As Senator Danforth was saying, whether they are public or private property is the baseline question.

Mr. MEAD. That is right.

I would be somewhat concerned about auctioning slots simply because of their value. I would be concerned that some potential entrants might not be able to afford the high price which would be attached to them.

Senator KASTEN. The other thing that could happen is that the larger airlines—and we could end up with five as Senator McCain is suggesting—could simply buy slots and not use them. By simply owning the slots and not using them, they could prevent new entry and further entry by limited incumbents and further exacerbate the monopoly situation. If you are going to have a deregulated environment, that by definition means that we have to be able to have entry into that market.

Mr. MEAD. We agree with you totally on that.

I do not understand how we have gotten to the present situation where a slot can go unused for a substantial part of the time. I just do not understand that.

Senator KASTEN. Have you reviewed the slot situation enough to know of specific examples where people—and I use the word—babysit a slot so that they have been able to control the slot in order to meet the minimal threshold requirements so that the slot does not become classified as an under- or unutilized slot?

Mr. WELLS. We have not been able to examine the market on an individual slot-by-slot basis in enough detail to identify particular slots—you know, 4:00 at National Airport—that are being babysat, as you say.

However, we have talked with a number of the airline schedulers around the industry, and they have been fairly straightforward with us about how they handle the slots that they have. A number of them have acknowledged that they have more slots than they

are currently using, that what they do with their excess slots is they lease them out to other carriers so that they can retain the option of using those slots in the future if they should decide that they want to use them.

I think our concern with slot leasing is that most of the slot leases we have seen offer very short terms, 30 days, 60 days, 90-day leases. If you are a large carrier at a slot controlled airport and you already have a number of slots, leasing a slot on a short-term basis like that could be useful because you can always—if you already serve, say, ten cities out of a slot-controlled airport—use a leased slot to serve an eleventh city, for example.

If you are a new carrier who is considering establishing new service at a slot-controlled airport, however, it really makes no sense to establish new service on the basis of a 30-day or 60-day or 90-day lease. So that while the leasing market is useful for incumbent carriers, I really do not think it is useful for new carriers seeking to enter those markets.

Mr. MEAD. I do not know why there should be a secondary market in slots to begin with.

Senator KASTEN. There should not be.

Mr. MEAD. These are public assets.

Senator KASTEN. It just makes common sense to use the process. These are assets that are supposed to be available to the industry.

Senator MCCAIN. Particularly since they got them for free.

Mr. MEAD. We have also found that in the secondary market, the extent that there are sales occurring it is often to related carriers—for example, to code-sharing partners of carriers that are already in that market.

Mr. WELLS. We have also found, if I could add, that there is underutilization based on the two different kinds of slots. There are air carrier slots for jet aircraft, and there are commuter slots for smaller propeller aircraft. We have found a number of cases where air carrier slots had been sold to commuter carriers, so that you have a jet slot that is designed to be used by a jet aircraft of 100 or more seats and is being used by a smaller propeller airplane that obviously can provide service to a smaller number of people with that slot.

Senator KASTEN. I would like to maybe ask that you look at this slot question in a little bit more detail. It seems that you have a lot of this information. We just need to get it in one place and get it organized and published. Working with the Chairman and the Ranking Member, I am going to try to request a more targeted slot report that you might be able to put together for us relatively quickly.

I have no further questions at this time. I thank you very much for your testimony.

Thank you, Mr. Chairman.

Mr. MEAD. Senator McCain, before you conclude, I just want to say what our plans are. We are taking the model results which would include a good bit on slots, and we plan to be prepared to testify later, I would say in July. We are trying to put it into a report to you all if that is compatible with what you would like.

Senator MCCAIN. It would be very welcome, and I certainly welcome Senator Kasten's many-year involvement and interest.

You have provided us with very important information, and I thank you for your testimony.

Finally, our next panel is:

Mr. Richard Mathias, Senior Vice President, Government Affairs, Pan American World Airways;

Mr. Timothy Hoeksema, who is President, Chairman and Chief Executive Office of Midwest Express Airlines;

Mr. John Fredericksen, President of the Regional Airline Association; and

Mr. James E. Johnson, President of American Association of Airport Executives, Senior Director of Airports of Hillsborough County, Tampa, Florida.

Please sit down, gentlemen, and thank you for your patience.

I think it is clear to you that this issue is of some interest to this committee, and we appreciate your patience in waiting.

Well, it looks to me like we have lost one.

Mr. Mathias, we would be glad to lead off with you.

STATEMENT OF RICHARD D. MATHIAS, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, PAN AMERICAN WORLD AIRWAYS

Mr. MATHIAS. Thank you, Senator McCain and Senator Kasten.

Senator MCCAIN. Excuse me. You are accompanied by General Bennett; is that correct?

Mr. JOHNSON. Yes, that is correct.

Senator MCCAIN. Thank you, Mr. Mathias. Please proceed. Obviously we would appreciate your summarizing, and your complete statements will all be made a part of the record. Proceed as you wish.

Mr. MATHIAS. Thank you, Senator McCain and Senator Kasten. Thank you for the opportunity to be here this afternoon. I have a fairly brief developed statement which I believe I can go through in three or four minutes maximum. You will be interested to know that it concentrates on the slot issue, which I believe is of particular interest to both of you.

I come here today thankful that I am not with DOT, although I do believe that life at Pan Am is in its own way difficult.

I do take some exception to your concern about the opinion of so-called many analysts. We admit that at Pan Am at this time we do not thrive, but we have demonstrated a very long developed ability to survive, and we intend to do so.

Senator MCCAIN. Mr. Mathias, let me clarify something if I could. It is not my view. I was reflecting the view of other analysts. I want you to survive and thrive because this is the whole reason, frankly, why we have proposed this legislation. We want you to thrive, and I hope you did not get the impression that we were forecasting your demise.

Mr. MATHIAS. I understand what you were referring to, and thank you, Senator.

There is much or some in the bill that Pan Am, as one of the smaller U.S. airlines, does support. I am speaking specifically with respect to CRS issues. I think we are of the view that any measure which would place limits on the market power conferred on the largest airlines through their control and ownership of CRS would

be welcome. Divestiture certainly would have been appropriate and practical six years ago when Pan Am first urged it. Whether it is still practical today is another question.

The need for measures of like effect to control the still-abusive aspects of CRS systems is still important and urgent.

I have reviewed the testimony of ASTA in connection with this, and I must say we completely agree.

I am not here to talk about CRS this afternoon. I want to talk about slots because it is of critical importance to Pan Am. I want to address section 7 which proposes to recapture slots at the high density airports and to reallocate them on a periodic basis to the highest bidders.

The irony of this proposal, while intended to stimulate new entry and promote competition, would have only one certain result, the crippling of Pan Am and serious injury to competition in the domestic airline industry.

I would add that I am equally concerned about the possibility that the recapture and auction ideas might appear in the pending FAA rulemaking.

Permit me to begin my quick sketch of where Pan Am is today and the importance of slots in that picture. Many people have an image of the Pan Am system that was formed in the 1970s or earlier. The Pan Am of today is greatly scaled down, and, counting all operations, Pan Am is only the eighth largest U.S. airline with just 6.8 percent of the industry's system RPMs.

The majority of Pan Am's operations are international, primarily through a trans-Atlantic hub at JFK and through a Caribbean Latin American hub at Miami. Our domestic operation consists of connecting services for our hubs and the Washington-New York-Boston shuttle service we instituted three years ago.

Looking solely at domestic operations, Pan Am accounts for 2.2 percent of the industry's domestic RPMs and is smaller than America West. Despite our relatively small presence as a domestic airline, domestic services are an essential part of the Pan Am system, and those services are heavily slot dependent. To be competitive in international markets and particularly in a market such as the trans-Atlantic, Pan Am has to be able to provide convenient connecting service at its hubs.

At JFK, Pan Am has eight daily nonstop flights arriving from Europe between 2:00 p.m. and 5:00 p.m. and 15 daily nonstop flights departing for Europe between 5:30 p.m. and 10:30 p.m. Feeding those flights, we have approximately 58 nonstop flights in domestic markets arriving and departing after 3:00 p.m.

Now JFK is subject to slot controls from 3:00 p.m. to 8:00 p.m. This means that Pan Am's trans-Atlantic service is totally dependent on its access to JFK slots. Nonetheless, the 75 slots that Pan Am presently has at JFK, including 31 international slots which are separately allocated and not subject to buy-sell, represent only 20 percent of the total slots available at that airport. Not one of these slots is surplus to Pan Am's competitive requirements.

Now as for Pan Am's shuttle, that was hardly a gift to the company. In 1986 Pan Am paid Texas Air $65 million for slots and gates at LaGuardia and Washington National. The DOT approved Texas Air's acquisition of Eastern only after it was assured that

Pan Am would have the hourly slots necessary to provide Eastern with its first direct shuttle competition. The Pan Am shuttle has been one of the few sustained successes of post-deregulation new entry, but it, too, is totally dependent on slots.

Nevertheless, the 30 slots that the Pan Am shuttle has at Washington National and the 62 slots it has at LaGuardia represent respectively less than 5 percent and 7 percent of the total slots at those airports. Again, these are the minimum number of slots that are required for the Pan Am shuttle.

Now aside from shuttle, Pan Am Airways has only eight slots at Washington National which are used to operate one daily roundtrip to JFK and three daily roundtrips to Miami. At LaGuardia, aside from shuttle, we have only ten slots, and those are used to operate five daily roundtrips from LaGuardia to Miami and back.

So if all or even some of these slots are recaptured and then auctioned off to the highest bidder, Pan Am would be placed in an untenable position. The company simply does not have the financial resources to engage in periodic bidding wars with the largest airlines in the Nation. Even if we did have the necessary resources, it would put Pan Am in the unique and highly unfair position of having to pay twice for operating rights which most other airlines acquired for nothing.

Finance resources aside, how could Pan Am possibly make any plans for the future when the operating rights which are basic to its system are subject to what in effect would be no more than short-term leases. Most airlines would be discomforted by such a development. Pan Am would be devastated by it.

No one can deny that the current system of slot allocation produces anomalies. The system is not perfect, but, in our view, this does not mean that an even more imperfect system is required.

Now the underlying difficulties that the high density rule itself creates a problem for which there is no perfect solution, the allocation of scare resources begins with the premise that not every participant in the market is going to have its resource requirements met. The continued need for the high density rule has not been the subject of serious challenge. Given the existence of the rule, the goal should be to find the allocation system which causes the least amount of market displacement.

The current system with its reliance on an open market for slots has largely met that goal. Largely, I said. Consider just one fact. Because of buy-sell, Pan Am was able to do something which had not been accomplished previously under either regulation or deregulation; that is, create a competitive shuttle service in the northeast corridor. We have also bought or sold 22 other slots in the last few years. To me, that is a system which is working as well as it can.

The major anomaly which has been created by the allocation system is the inability of a new entrant such as America West to obtain the relatively small number of additional slots it requires at LaGuardia and National to maintain a substantial pattern of service to the west.

I do not mean to belittle America West's concern. It is very serious, and I understand Midwest Express may have the same con-

cerns. These are serious. As I said before, aside from the shuttle we are in the same position they are.

At the same time, the efforts to accommodate America West or Midwest Express or other new entrants should not result in the setting up of an auction system which would be the destruction of the Pan Am shuttle and the crippling of Pan Am.

I have some ideas as to what might be done if you are going to adopt some takeaway situation and develop a measured approach which tailors a solution to the problem. First, every effort should be made by the FAA to find new additional slots. It is possible to create new slots. Apart from the statutory freeze at Washington National,[1] the total slots available at each airport are not carved in stone. They are no more than the administrative estimates of capacity which are, for the most part, more than 20 years old.

Secondly, to the extent that existing slots are looked at for award to other airlines, the international slots at JFK should be excluded. They are already excluded, as I said before, from the buy-sell rule.

I would add that the international and foreign policy considerations could not be avoided by just excluding the slots held by foreign airlines, because that would create a severe competitive imbalance for Pan Am and other U.S. flag carriers.

Thirdly, any system of recapture must take into account the consideration of the likely competitive impact of that action. Recapturing all or even some of the slots held by all of the airlines would do severe damage to competition in the domestic airline industry. If recapture is necessary, it should be limited to the number of slots that are really required and focused where it would do the least amount of damage; that is, taking away slots held by the largest least slot-dependent airlines.

Finally, in a similar vein, any system of reallocation must take into account competitive realities. An administrative reallocation is the only system that might work. In fact, prior administrative reallocations have functioned fairly well in meeting the airlines' competing requirements. An auction system would not work. It would not only be a perverse form of tax, it would make the accumulation of market power by the largest airlines more possible and more probable.

Thank you very much.

[The attachment referred to follows:]

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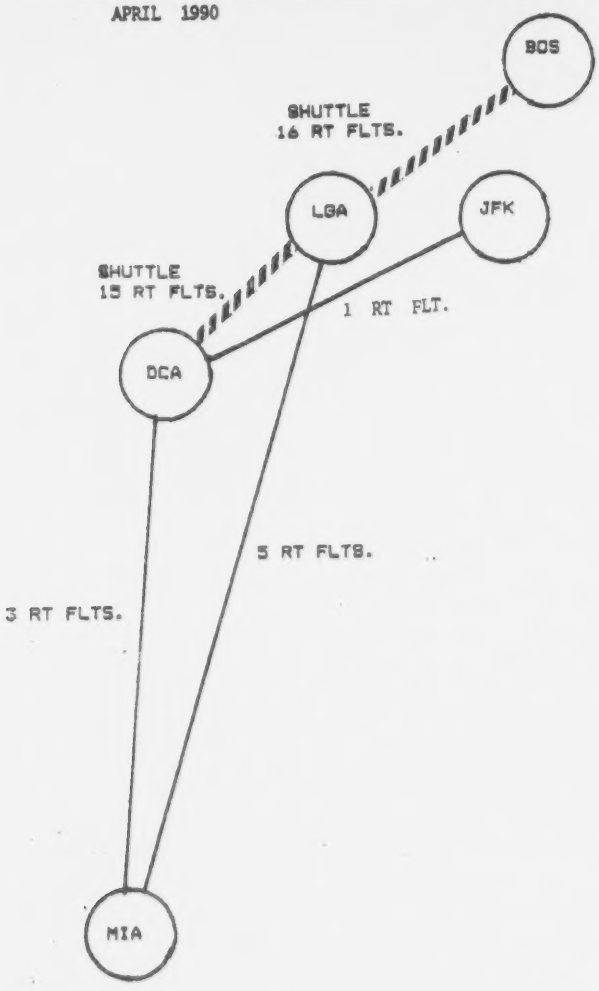
[1] Pursuant to Section 6009(e)(1) of the Metropolitan Washington Airports Act of 1986, P.L. 99-500, the FAA may not increase or decrease (except for safety reasons) the number of slots at Washington National.

Appendix A
To Pan Am Testimony
on S.1741

PAN AM SLOTS AT WASHINGTON NATIONAL AND NEW YORK LA GUARDIA
ARE PRIMARILY USED FOR THE PAN AM SHUTTLE OPERATION

APRIL 1990



//////// SHUTTLE

Senator FORD. Timothy, are you ready?

STATEMENT OF TIMOTHY HOEKSEMA, PRESIDENT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, MIDWEST EXPRESS AIRLINES

Mr. HOEKSEMA. Thank you, Mr. Chairman.

Senator FORD. I am very careful about your last name.

Mr. HOEKSEMA. It is a difficult one.

Senator FORD. I am bilingual; you know, southern and bad English.

Mr. HOEKSEMA. I have a brief statement that summarizes the written statement that I have submitted.

I very much appreciate the opportunity to appear before you today to discuss S. 1741 and issues affecting airline competition. First, let me say that I support deregulation. Deregulation has achieved significant benefits for air travelers and the travel industry. Importantly, if it were not for deregulation Midwest Express would not exist.

This is not to say that the current system cannot be improved. In fact, I believe the system must be changed in several respects to further improve competition. Without changes, the gains of deregulation will be slowly eroded, and the system, I fear, will be worse than ever.

S. 1741 raises issues that are legitimate concerns for the industry. For your background, Midwest Express began commercial service in June 1984 using three DC-9s to serve three cities through its hub at Milwaukee. Today, Midwest Express operates 13 aircraft serving 19 cities throughout the United States. We employ more than 800 people, and in 1989 we provided air transportation to nearly 550,000 passengers.

Our revenue passenger miles increased 51 percent in 1989 over the previous year, and our total revenue increased 50 percent. Success, however, has not come easily. Several factors place new carriers at a severe competitive disadvantage.

Of greatest concern to Midwest Express are slot restrictions, abuses of computer reservation systems and the unavailability of airport facilities. We are pleased that at least two of these concerns are addressed in S. 1741. Obtaining more slots at Washington National and New York's LaGuardia Airports is one of Midwest Express' highest priorities. In late 1985 we were able to obtain four slots at National, and in 1986 we were able to obtain four slots at LaGuardia. Both acquisitions were through means that are no longer available to carriers. Later we were able to lease two more slots at LaGuardia.

Under the current buy-sell, however, we see little or no hope of acquiring more permanent slots at these airports. To my knowledge, no slots have been available for purchase by small carriers since the rule was issued. Four slots permitting two flights a day is not sufficient to compete in those markets. It does not permit the frequency of flights necessary to attract passengers, and it underutilizes staff and assets that are dedicated to those airports. It also eliminates any possibility for Midwest Express to expand operation to serve new hub airports.

We ask that any legislation dealing with reallocation of slots give special consideration not only to new entrants but also to incumbent carriers that have 12 or fewer slots at the respective high density airport.

New entrants should be able to enter a market and grow to a certain minimum level of flights that justifies the investment in that market. We do not believe that an auction of all slots as contemplated by S. 1741 is necessary. Instead, in our written submission we have proposed two methods of withdrawing slots to meet the needs of new entrants and small incumbents that are less disruptive to large carriers.

Despite repeated assurances from the Department of Transportation that is reviewing the slot distribution regulations and despite legislation requiring such a review, DOT has not provided any relief. We believe that DOT has had adequate time to act and that Congress should mandate that slots be set aside at high density airports for use by new entrants and small incumbent airlines.

Another concern to Midwest Express is equitable access to computer reservation systems. We support the provisions of S. 1741 that require air carriers to divest ownership of CRSs. CRSs have become vital to air carriers; yet, the development of such systems is well beyond the financial means of small carriers, and the high cost imposed for participation in the system has exceeded a rational basis. Not only must small nonvendor airlines pay excessive booking fees, but we too often must suffer by having inaccurate and untimely information displayed about our flights. The display of inaccurate data frequently causes lots of revenue, and, more importantly, it causes travel agents to be reluctant to rely upon the CRS data pertaining to nonvendor carriers. Even after divestiture, rules regulating CRSs will be needed to minimize abuse by vendors, but divestiture should relieve some of the regulatory burden.

A major obstacle to new competition not addressed by S. 1741 is the unavailability of airport facilities. Many airports have a scarcity of gates and ticket counter space. In some cases, the scarcity is due to long-term leases. In other cases, the scarcity is due to the local airport manager's decision to market facilities to the fewest number of carriers.

When gates are not available directly from airport authorities, small carriers are forced to sublease space from existing leasehold carriers. In such cases there is little ability for the new entrant to negotiate favorable terms. As a consequence, costs are excessive and subject to increase with little notice. The contract is subject to termination upon short notice, and often the lessor insists on being held completely harmless for its negligence.

Often, the leasehold carrier requires that new entrants use the leasehold carrier's personnel at ticket carriers and at boarding areas. It is particularly irksome to have the performance of our airline resting in the hands of our competitors.

In conclusion, S. 1741 addresses some of the most serious impediments to competition. We urge Congress to provide a method for small incumbent airlines to obtain slots and to protect small carriers from the abuses of CRSs.

Finally, although other provisions of S. 1741 may promote competition, we believe it is more important that the legislation address the unavailability of airport facilities.

[The statement follows:]

STATEMENT OF
TIMOTHY E. HOEKSEMA
PRESIDENT OF MIDWEST EXPRESS AIRLINES, INC.

BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION
UNITED STATES SENATE

APRIL 5, 1990

Thank you, Mr. Chairman. I am Timothy E. Hoeksema, President of Midwest Express Airlines, Inc. I appreciate the opportunity to appear before you today to address issues affecting airline competition and, in particular, to discuss S. 1741.

First, let me say that I support economic deregulation. Deregulation has achieved significant benefits for air travelers and the travel industry. And, importantly, if it were not for deregulation, the public would be deprived of the unique services of Midwest Express, because, without deregulation, Midwest Express would not exist.

This is not to say that the current system cannot be improved. In fact, I believe there must be changes to further improve competition in the industry. Without changes, the gains of economic deregulation will be slowly eroded, and the system, I fear, will be worse than ever. S. 1741 raises issues that are legitimate concerns for the industry, and I commend the effort demonstrated by this legislation and these hearings to make the industry more competitive.

I. ORIGINS OF MIDWEST EXPRESS

Before I comment specifically on S. 1741, I would like to describe the origins of Midwest Express. Our airline originated from the frustration that has been encountered in many sections of this country with deregulation, but the growth and success of our airline also demonstrates how deregulation has made it possible to resolve these frustrations. The challenge now is to create an environment that will permit small airlines such as Midwest Express to survive and compete in an industry that has become dominated by a relatively small number of carriers.

Midwest Express began commercial service in June 1984 as an outgrowth of Kimberly-Clark Corporation. Prior to that time, Kimberly-Clark, the ultimate parent corporation of the airline, had been actively engaged in aviation matters. Kimberly-Clark formed an aviation department in 1948 when it needed to transport its logging personnel to remote woodlands.

The reputation of Kimberly-Clark in the aviation industry expanded over the years and other corporations sought out Kimberly-Clark's expertise when it came to maintaining and refurbishing corporate aircraft. Then, in 1969, Kimberly-Clark created a subsidiary called K-C Aviation Inc. that specializes in services for corporate jet aircraft.

With decentralization of Kimberly-Clark's executive offices in 1980, there was an increasing need to transport employees in an efficient manner.

Kimberly-Clark faced the same travel problems that other businesses face. Many employees were located in small or mid-sized communities that were served by air carriers that offered circuitous and undependable flights. The cost of air travel from those small communities was escalating at a pace in excess of inflation, and employees were wasting too much time in airports waiting for connections. Travel expenses for hotels and meals were skyrocketing with the need for more overnight stays. Employee morale was being adversely effected by the drudgery of travel, and it was increasingly difficult to recruit employees to places where air service was poor.

In January 1983, Kimberly-Clark decided to combat these problems by acquiring large aircraft and offering an in-house corporate shuttle. No sooner had the corporate shuttle begun than it was overwhelmed by success. Employees loved it. Morale improved. Travel costs decreased. Business was performed more efficiently.

Deregulation made it possible for Kimberly-Clark to create Midwest Express and thereby introduce the public to the type of superior air service that Kimberly-Clark provided its own employees. Midwest Express began operations using 3 D-C9's to serve three cities through its hub at Milwaukee. At that time, it was clear that Milwaukee was underserved by the existing air carriers. Without Midwest Express, I am convinced that the aviation service at Milwaukee would have deteriorated even further.

Since then, Midwest Express has grown to operate 13 aircraft serving 19 cities throughout the United States. We employ more than 800 people, and in 1989, we

provided air travel to 546,000 passengers. Our revenue passenger miles increased 51% in 1989 over the previous year and total revenue increased 50%. Last month, we began operating two new MD-88 aircraft serving San Diego, Los Angeles, and San Francisco from Milwaukee, marking our transition to a national carrier.

II. FACTORS INHIBITING COMPETITION FROM NEW AIR CARRIERS

This is not to say that success has come easily. The many failures of other airlines since deregulation is testimony to the difficulties encountered by new airlines. Several obstacles place new carriers at a severe competitive disadvantage. These obstacles include slot restrictions at major airports; computer reservation systems owned by large carriers; entrenched rights to scarce airport gates, ticket counters and other airport facilities; frequent flyer programs that have been effective in creating loyalty to existing carriers with large route structures; code-sharing arrangements; and travel agency commission overrides. Any one of these is a serious challenge for a new carrier; in combination, they create a formidable barrier to new competition.

Three of the competitive obstacles of greatest concern to Midwest Express that deserve legislative or regulatory attention are: slots, computer reservation systems and access to scarce airport facilities. We are pleased that at least two of these concerns are addressed in S. 1741.

III. UNAVAILABILITY OF SLOTS AT HIGH DENSITY AIRPORTS

Midwest Express began its efforts to gain slots at Washington's National and New York's LaGuardia Airports a full year prior to its startup; it has been trying to obtain slots at those Airports ever since. In late 1985, we were able to obtain four slots at National and in 1986 were able to obtain four slots at LaGuardia. Both acquisitions were through means that are no longer available to carriers. Later, we were able to lease two more slots at LaGuardia. Under the current regulatory framework, however, we see little or no hope of ever acquiring more permanent slots at these Airports.

Obtaining more slots at National and LaGuardia is one of our highest priorities. Four slots--which permit just two flights per day--is not sufficient to compete successfully in those markets. It does not permit the frequency of flights necessary to attract passengers and it underutilizes staff and assets that are dedicated to those Airports. It also eliminates any possibility for Midwest Express to expand operations to serve new hub airports.

Although S. 1741 addresses the problem of slots, we ask that the legislation make clear that special consideration in the reallocation of slots be provided not only to new entrants but also to incumbent carriers that have twelve or fewer slots at the respective high density airport. New entrants should be able to enter a market and grow to a certain minimal level of flights that justifies the investment in that market. Often a new entrant does not have

the resources to use as many as twelve slots beginning at once. But, without the ability to grow quickly to at least six flights to an airport, a carrier often is faced with a losing proposition. The carrier's costs in starting operations cannot be absorbed by the frequency in that market, and the pattern of service with fewer than six flights makes it difficult to efficiently schedule employees at the airport.

We do not believe that an auction of all slots as contemplated by S. 1741 is necessary. We have proposed two methods of withdrawing slots to meet the needs of new entrants and limited incumbents that are less disruptive to large carriers. One proposal provides for a limited withdrawal of slots based upon procedures similar to those used by the FAA in allocating slots under Special Federal Aviation Regulation (SFAR) No. 48 in 1986. This is described in detail in Exhibit 1 to this statement. The other proposal creates a permanent pool of slots for the exclusive use of new entrants and limited incumbents. This proposal is described in Exhibit 2. Both of these proposals have been submitted to the FAA, but the FAA has repeatedly refused to withdraw slots from existing carriers. We believe the FAA's reluctance to make slots available for small airlines is a serious impediment to competition that can and should be remedied.

Let me briefly provide background that has led to the frustration of Midwest Express as it has attempted to reach a minimal level of frequency at National and LaGuardia Airports. In June 1983, Midwest Express participated in its first slot lottery. At that time, the only method for obtaining slots was through lotteries conducted under the Interim Operations Plan which was an

emergency plan to reduce traffic at various air traffic control facilities where FAA services had to be reduced because of the air traffic controllers' strike.

The Interim Operations Plan had been structured so that impacted incumbent airlines and incumbents who had passed in previous slot lotteries were given priority over new entrants in later lotteries. Accordingly, slots of any value were selected by large incumbents before new entrants were given an opportunity to select slots. The effect was that new entrants coming into the lottery in 1983 had no opportunity to compete at major airports.

When the Interim Operations Plan terminated, slots were allocated through scheduling committees. These committees had been organized to help the industry comply with the FAA's High Density Rule. Under the scheduling committee process, air carriers had to agree unanimously to a redistribution of slots before any slot holdings could be changed. The result was that, in the 1980's, slot committees were usually deadlocked and no slots were distributed. There was no incentive for large incumbent carriers to relinquish slots to permit competition from new carriers. Once again, new entrants were frozen out of the marketplace.

Then, in December 1985, the FAA aggravated the situation further; it rewarded large carriers for not relinquishing slots to new entrants by "grandfathering" all existing slots to incumbent carriers and creating a buy-sell rule so that new entrants had to purchase slots from the carriers that had been awarded the slots for free. While the buy-sell rule appealed to our free-market

instincts, it has failed as a means for small airlines to acquire slots. To my knowledge, no slots have been available for purchase by small carriers since the beginning of the buy-sell rule. The transactions that have occurred generally involve small carriers selling slots to large carriers or slots being transferred between large carriers as part of complex transactions involving trades of airport facilities or other assets or as settlements to litigation.

During the 1980's, the only systematic attempt to provide an opportunity for new entrants and small incumbent airlines to compete at high density airports was through a withdrawal lottery in 1986 under SFAR No. 48. The process was a tremendous success from Midwest Express' perspective because it provided Midwest Express the permanent slots that it operates at Washington National and LaGuardia today. SFAR No. 48, however, was a one-time exercise that expired at the end of 1986. Since then, there has been no reliable, predictable or effective method for new entrants or limited incumbent airlines to gain access to National or LaGuardia Airports.

The current buy-sell system offers no hope that limited incumbent airlines will be able to acquire slots. Despite repeated assurances from the Department of Transportation that it is reviewing the slot distribution regulations and despite legislation requiring such review, DOT has not provided any relief. We believe the DOT has had adequate time to act and that Congress should mandate that slots be set aside at high density airports for use by new entrants and limited incumbent airlines.

8

V. DIVESTITURE OF AIRLINES' OWNERSHIP OF COMPUTER RESERVATION SYSTEMS

Another area of concern to Midwest Express is equitable access and use of computer reservation systems. In general, the current computer reservation system rules provide fertile ground for unfair competition. We support the provisions of S. 1741 that require air carriers to divest ownership of computer reservation systems.

Computer reservation systems (CRSs) have become vital to air carriers. And yet, the development of such systems is well beyond the financial means of small carriers, and the high cost imposed for participation in the systems owned by large carriers has exceeded a rational basis. Studies by the Department of Transportation and the General Accounting Office confirm the excessive revenue received by airline CRS vendors from booking fees.

Not only must small airlines pay excessive booking fees to participate in computer reservation systems, the airlines too often must suffer by having inaccurate and untimely CRS information displayed about its flights. The display of inaccurate data frequently causes loss of revenue and, more importantly, it causes travel agents to be reluctant to rely upon the CRS data pertaining to non-vendor carriers.

While it is true that computer reservation systems have provided a means for small carriers to market their services, the benefit is not all that clear. Midwest Express must hire additional persons simply to monitor the accuracy of information displayed in computer reservation systems. Even then, the

monitoring of the large volume of constantly changing data in CRS displays for each city and its potential airline connecting patterns is beyond the means of a carrier the size of Midwest Express. The combinations of routes and fares are endless, and the cost of thorough monitoring is prohibitive. Too often we have received telephone calls from potential passengers who inform us that Midwest Express flights are not displayed in the computer reservation system used by their travel agents. There is no easy way to prove that omissions such as these are ones of innocent oversight by the CRS vendor in loading the data, flaws in the software system, or deliberate acts of sabotage.

Even after divestiture, rules regulating computer reservation systems will be needed to minimize abuse by vendors. Computer reservation systems have become so important to the air travel industry that the public deserves assurance that systems are available on an equitable basis and accurate information is displayed. Active regulatory oversight will be needed, but divestiture should relieve some of the regulatory burden.

V. INACCESSIBILITY TO AIRPORT FACILITIES

One major obstacle to new competition not addressed by S. 1741 is the lack of airport facilities. Many airports have a scarcity of gates and ticket counter space. In some cases, the scarcity is due to long term leases and other contractual relations with major carriers. For example, when we began operations at Los Angeles, the airport authority informed us that there were gates that were not being used, but the authority could not permit Midwest Express to use them because they were subject to a long term lease. In other

cases, the scarcity of gates is not due to lease agreements, or other contractual relations, but due to the local airport manager's decision to market facilities to the fewest number of carriers. The rules for leasing facilities vary from airport to airport and change frequently, but one example of the problem arises when airports decline to lease space to new entrants unless the new entrant agrees to lease a minimum number of gates and ticket counters. This effectively precludes the availability of such space to small carriers.

When gates are not available directly from airport authorities, small carriers are forced to sublease space from existing leasehold carriers. In such cases, there is little ability for the new entrant to negotiate favorable terms. The leasehold carrier often requires the new entrant to use the leasehold carrier's personnel to provide ground services for the new entrant's aircraft and cargo. Contract terms for these services are usually presented to the new entrant on a "take it or leave it" basis. As a consequence, costs are excessive and subject to increase with little notice, the contract is subject to termination upon short notice, and usually the lessor insists on being held completely harmless or, at best, held liable only for its gross negligence.

Often the leasehold carrier insists that the new entrant use the leasehold carrier's personnel at ticket counters and in boarding areas. The customer services provided by the leasehold carrier are usually not the same quality that Midwest Express expects of its own employees. This is potentially disastrous to a carrier such as Midwest Express that has built its reputation

on excellent service. It is particularly irksome to have the performance of our airline resting in the hands of our competitors.

VI. CONCLUSION

In conclusion, Midwest Express continues to support economic deregulation. We believe it has benefited consumers, and our industry, greatly. However, regulation still exists in the form of slot controls, CRS rules, and local restrictions on the availability of airport facilities. Some form of regulation of these areas is necessary, but the regulations should permit new competition rather than inhibit it. Otherwise, deregulation is destined to fail.

S. 1741 addresses some of the most serious impediments to competition. We particularly urge Congress to provide a method for new entrants and small incumbents to obtain slots. New competition has been foreclosed at LaGuardia and Washington National Airports long enough, and we have lost faith that the Department of Transportation will address this problem. We support the provisions of S. 1741 requiring divestiture of computer reservations systems by airlines. Finally, although other provisions of S. 1741 may promote competition, we believe it is more important that the legislation address the unavailability of airport facilities.

The success of Midwest Express has come against seemingly insurmountable odds. Steady growth is imperative for us to survive. Without legislative action, our options for expansion will be extremely limited. We urge this Subcommittee to take action to insure the success of the best principles of deregulation.

Exhibit 1
to Statement of
Timothy E. Hoeksema, President
of Midwest Express Airlines, Inc.
Page 1 of 5

WITHDRAWAL LOTTERY SIMILAR TO SFAR NO. 48.

The following proposed rule is based upon Special Federal Aviation Regulation No. 48 which was issued March 12, 1986 (51 Fed. Reg. 8632). The proposal is effective for 5 years. It modifies SFAR No. 48 to prevent abuses that were made by a few airlines.

Section 1. Purpose

The purpose of this Special Federal Aviation Regulation (SFAR) is to accomplish each year for five years a withdrawal of slots that were allocated under Subpart S of Part 93 to incumbent carriers and a reallocation by lottery of those slots and slots otherwise available to new entrant carriers and limited incumbent carriers desiring additional slots at LaGuardia and Washington National Airports. At the end of the five years, the Administrator will review the merits of continuing this SFAR.

Section 2. Definition and Relationship to 14 CFR Part 93, Subparts K and S

Terms used in this SFAR have the same meanings as used in Subparts K and S of Part 93, except for purposes of this SFAR, limited incumbents shall mean carriers with fewer than 18 slots at either LaGuardia or Washington National Airports. The provisions of Subparts K and S of Part 93 shall be considered when applying this SFAR. However, this SFAR supersedes inconsistent provisions in both Subparts.

Section 3. Lottery Process - General

(a) Utilizing the air carrier slot pools established by the FAA under §93.223(a)(3), the FAA shall hold lotteries to determine those slots to be withdrawn from incumbent carriers at LaGuardia and Washington National Airports. The drawings shall be conducted annually after issuance of this SFAR for five years. A notice of each lottery shall be published by the FAA announcing the time and place of the lotteries.

(b) Separate drawings shall be conducted for air carrier slots for each lottery and for each of the high density airports identified in paragraph (a).

(c) The slots selected in each drawing shall be determined in accordance with sections 4(c) and (e).

(d) The FAA may issue special procedures to be in effect for the lotteries.

(e) None of the slots withdrawn shall be slots used for international operations, as specified in §93.217(a)(1), or necessary for essential air service.

(f) None of the slots withdrawn shall be from carriers holding 18 or fewer non-international air carrier slots at the particular airport.

(g) Each U.S .air carrier operating at the airport with fewer than 18 total slots (including all international or domestic, commuter or air carrier slots) shall be included in the lotteries to obtain slots under this SFAR is the carrier notifies the Office of the Chief Counsel, Docket Section, AGC-204, 800 Independence Avenue, S.W., Washington, D.C. 20591, that it desires to participate in the reallocation lottery. The notification must be in writing and must be submitted in duplicate by ten days prior to each lottery held pursuant to this SFAR. The notification must include a certified statement signed by an officer of the operator indicating that the operator operates or has contracted for sufficient aircraft having a maximum seating capacity of 56 or more to use the slots to be obtained and that the operator has bona fide plans to use all requested slots within the timeframe described in section 6.

(h) Any U.S. new entrant air carrier wishing to initiate scheduled service at the airport, shall be included in the lottery if it: (1) has appropriate economic authority under Title IV of the Federal Aviation Act of 1958, as amended; (2) has FAA operating authority under Part 121; and (3) notified the Office of the Chief Counsel, Docket Section, AGC-204, 800 Independence Avenue, S.W., Washington, D.C. 20591, that it desires to participate in the lottery. The notification must be in writing and must be submitted twenty days prior to each lottery held pursuant to this SFAR. The notification must include a certified statement signed by an officer of the operator indicating that the operator operates or has contracted for sufficient aircraft having a maximum certificated passenger seating capacity of 56 or more to use the slots to be obtained and that the operator has bona fide plans to use all requested slots within the timeframe described in section 6.

(i) No air carrier that is a party to a proposed merger or other business combination for which U.S. Government approval is pending may participate in any lotteries under this SFAR if such merger or combination is with an incumbent carrier holding 30 or more slots at the airport to which the lottery applies.

(j) No air carrier shall be eligible for any lotteries to obtain slots under this SFAR if at any time in the two years prior to any such lotteries it:

(1) obtained slots under section 5 and failed to use them in accordance with section 6; or
(2) sold, leased, or transferred, for consideration other than one or more slots at the same airport, the slots selected in a lottery held under this SFAR.

Section 4. Withdrawal Process.

(a) The name of each air carrier with 30 or more non-international air carrier slots (5 days a week or more) at the airport shall be placed in individual capsules for inclusion in a drawing. The name of each such carrier shall be placed in a number of capsules equal to 5 percent of the total number

of air carrier slots held by that carrier (5 days a week or more) at that airport in accordance with Part 93, Subpart S, rounded to the next lowest number, but not less than one. The date used to determine slot holdings under this paragraph shall be twenty days prior to each lottery held under this SFAR.

(b) After each capsule is placed in a drum, a random drawing shall be held to determine the order for the selection of slots to be withdrawn.

(c) Before any carrier is required to designate slots for withdrawal, unallocated slots and slots available in accordance with 14 CFR §§93.224 and 93.227 shall be designated for reallocation under section 5 of this SFAR. Those slots shall be used to satisfy the provisions of paragraph (e) of this section.

(d) Each time a carrier's name is called, it shall designate two slots (or one if that is all that is required) to be withdrawn and reallocated from the most current base available to the FAA. A carrier shall have 5 minutes to designate its slots to be withdrawn or the FAA representative will. Any slot designated must be in the carrier's base at least 5 days a week.

(e) Each slot designated must be within hours controlled under the 14 CFR Part 93, Subpart K, and no more than two slots may be designated in each controlled hour. If two slots have been designated in each of the controlled hours of the day, a carrier required to designate additional slots may do so in any of the controlled hours. If a carrier does not have a slot in a required hour, it may name a slot in any controlled hour.

(f) No carrier shall be required to designate more than 5 percent of its total of non-international air carrier slots (5 days a week or more) at the particular airport.

(g) Slots designated for withdrawal under this section shall retain the same withdrawal priority numbers as established under Subpart S of Part 93 when reallocated pursuant to section 5 of this SFAR. However, slots reallocated under section 5 shall not be withdrawn under Subpart S, for EAS or international operations, from the carrier selecting the slot for a period of 2 years after the effective date of this SFAR.

Section 5. Reallocation Lotteries.

(a) Within 48 hours following the withdrawal lottery, a lottery to allocate the slots withdrawn pursuant to section 4 and those otherwise available shall be held on an airport-by-airport basis.

(b) Random drawings shall be held to determine the order of slot selection by the carriers eligible under section 3.

(c) An operator may select up to two slots available at the airport during each selection sequence, except that new entrant carriers may select up to four slots, if available, in the first sequence.

(d) At the lottery, each operator must make its selection within 5 minutes after being called or it shall lose its turn. If capacity still remains after each operator has had an opportunity to select slots, the allocation sequence will be repeated in the same order.

(e) No carrier may select more than 18 slots under this SFAR or select any slots that would result in it having a total of more than 18 slots at any one airport to which this SFAR applies, less:

(1) the number any slots lost under §93.227(a) during the previous 365 days, and
(2) the number of slots voluntarily relinquished by the carrier in the previous 365 days.

(f) If all eligible carriers decide not to select additional slots or have selected their maximum number of slots, the lottery at that airport will end and the remaining slots will be returned to the carriers designating them, if any, in accordance with section 4.

Section 6. Slot Use.

(a) The initiation of operations with slots reallocated pursuant to this SFAR shall be accomplished no earlier than 90 days and no later than 180 days after the lottery is held pursuant to section 5.

(b) Each carrier obtaining a slot under section 5 shall give the carrier losing the slot under section 4, if any, and the FAA, at least 90 days written notice prior to initiation of service. The notice to the FAA must be mailed to the address set forth in section 3(g).

(c) Slots obtained under section 5 shall only be used by the carrier obtaining them for scheduled non-international passenger service.

(d) Slots allocated under section 5 which were withdrawn from an incumbent carrier under section 4 will be returned to the incumbent carrier if:

(1) The carrier obtaining the slot under section 5 fails to give the notice required by section 5 or does not utilize the slot within 14 days after the date which it states it will begin to utilize the slot; or
(2) The carrier obtaining the slot loses it under 14 CFR §93.227(a) within 180 days after initiating service.

(e) The slot "use-or-lose" provision of §93.227(a) of the Federal Aviation Regulations shall apply to those slots allocated under this SFAR as of the date the carrier obtaining the slots actually initiates service. The provisions of §93.227(b) do not apply to the slots allocated under this SFAR.

(f) A slot obtained under section 5 may only be traded on a one-for-one basis or for an increased number of slots at the same airport for 365 days after the carrier obtaining it under section 5 initiates use of that slot. The restrictions of this SFAR apply to any slots obtained in such a trade.

(g) For 365 days after initiation of service with any slot obtained under this section, it must be utilized with aircraft having a certificated maximum passenger seating capacity of 56 or more. After 365 days, the

provisions of 14 CFR Part 93, Subpart S, apply as to the kind of aircraft eligible to be utilized with the slot.

(h) For 365 days after obtaining slots under the lottery set forth in section 5, a carrier may not transfer or lease for any consideration, other than one or more slots at the same airport, any slots at that airport that the carrier had obtained prior to such lottery.

Exhibit 2
to Statement of
Timothy E. Hoeksema, President
Midwest Express Airlines, Inc.
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A PERMANENT POOL OF PROVISIONAL AIR CARRIER SLOTS FOR WASHINGTON NATIONAL AND NEW YORK'S LAGUARDIA AIRPORTS FOR THE EXCLUSIVE USE OF NEW ENTRANTS AND LIMITED INCUMBENTS.

A permanent pool of 26 provisional slots would be available exclusively for new entrants and limited incumbents. The provisional slots would have to be returned to the FAA when the carrier holding the slots became a major carrier at the airport or no longer met the use-or-lose requirement for any reason. These slots would not be subject to any leasing or selling or transferring in any way and therefore could not be obtained for the purpose of gaining a quick profit.

The pool is likely to provide a constant source of slots for new entrants and limited incumbents. As a general rule, new entrants and limited incumbents have expanded operations to become a major carrier at the airport, merged with existing large carriers, or gone out of business. In any of these cases, the provisional slots would be returned to the pool for redistribution to other new entrants and limited incumbents.

SOURCE OF POOL

A pool of 26 slots would be created from two sources. One source would be to withdraw slots from major slot holders at the airport (any air carrier with more than 20 slots would be deemed a major slot holder), and the other source would be from increasing the limit of operations in non-peak operating hours.

First, at DCA one slot per hour from 0700 through 2100 would be withdrawn from each major slot holder. This would generate 15 slots evenly distributed throughout the day. At LGA one slot would be withdrawn in every other half hour period starting at 0700. Several methods could be used to make the withdrawal of the 15 slots occur in an equitable manner among the major holders.

Another 11 slots would be created at each Airport by the FAA raising the limit of operations per hour by one in all hours except the four peak hours at each airport.

All slots in the pool would have a special tag number to identify them as provisional and to distinguish the provisional slots withdrawn from air carriers from the provisional slots created by the FAA. LGA pool slots would be usable for either arrival or departure by new entrants or limited incumbents.

Exhibit 2
to Statement of
Timothy E. Hoeksema, President
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DISTRIBUTION AND USE RULES FOR THE PROVISIONAL SLOT POOL

Once per year the FAA would hold a lottery for qualified new entrants and limited incumbents to seek any available provisional slots. A limited incumbent would be a carrier with 12 or fewer regular slots at the respective Airport. Use of provisional pool slots would be the following rules:

1. These slots may never be sold. They may never be traded for other assets or for slots at other airports. Intra-airport trades would always be temporary, with the slot reverting to its original timeframe should it revert to the FAA for any reason.

2. Should the new entrant or limited incumbent be merged or go bankrupt, all provisional pool slots held by that carrier would be returned to the FAA for redistribution in the next annual lottery.

3. Between annual lotteries, any provisional slot not in use by new entrants/limited incumbents would be allocated as follows,

   a) Provisional slots created by the FAA through increased hourly operations would not be used by any carrier.
   b) Provisional slots that were withdrawn from major slot holders could either be temporarily returned to the original major slot holder or auctioned for short term lease by FAA to the highest bidder.

4. Should a limited incumbent using pool slots gain regular carrier slots and lose limited incumbent status, the provisional slots would revert to the FAA automatically via the following sliding scale:

RULES FOR PROVISIONAL SLOT USE BY LIMITED INCUMBENT CARRIER WITH OPPORTUNITY TO INCREASE HOLDING OF REGULAR SLOTS

PROVISIONAL SLOTS HELD (BASE)	REGULAR AIR CARRIER SLOTS GAINED	TOTAL # SLOTS HELD		SLOTS RETURNED TO FAA		TOTAL CARRIER SLOTS
8	4	12	-	0	=	12
8	6	14	-	1	=	13
7	8	15	-	1	=	14
6	10	16	-	1	=	15
5	12	17	-	1	=	16
4	14	18	-	1	=	17
3	16	19	-	1	=	18
2	18	20	-	1	=	19
1	20	21	-	1	=	20

Senator FORD. Thank you.
Mr. Fredericksen.

STATEMENT OF JOHN S. FREDERICKSEN, PRESIDENT, REGIONAL AIRLINE ASSOCIATION

Mr. FREDERICKSEN. Thank you, Mr. Chairman. I have submitted a full statement for the record. I would just like to take a few minutes of the subcommittee's time to talk about code-sharing.

The membership in my organization is particularly concerned about the provision of S. 1741 which, if an enacted, would severely disrupt the current structure of the U.S. regional airline industry. 51 regional airlines are currently involved in a code-sharing relationship with a major airline. Those 51 carriers comprise the bulk of the regional airline industry. They carry 90 percent of the passengers that are carried on regional airlines.

The code-sharing relationships range from outright ownership by major airlines, which is true in 15 cases, to partial equity ownership by the major airline, which is true in four cases, to pure marketing alliances devoid of any ownership by the major airline. That is true in 32 cases.

We believe that code-sharing offers many benefits to the regional airline passenger. You heard some of those from Mr. Shane today. It features coordination of schedules and thus greatly enhanced travel capabilities for the people from the small- and medium-sized communities in the country. The single ticketing source, usually the CRS, provides such amenities as through baggage check-in, advance seat assignments, and boarding passes for connecting flights that would never be available to the small town passenger without this system.

The really popular thing we have already talked about today is the frequent flyer mileage. People in the small- and medium-size communities like that frequent flyer mileage they get riding on the code-sharing carrier.

Probably the most important advantage, though, is that the price is less. On the code-sharing airline, if you are going to connect on a major airline, almost always the add-on fare is much less than it would be if the two airlines operated independently.

Competition among code-sharing regional carriers is extremely vigorous. That competition takes two forms. I wish Senator Danforth were here.

Senator FORD. So we do. We were just talking about that. Where is Jack when we need him?

Mr. FREDERICKSEN. In Springfield, Missouri, for example, a passenger has the option of TWA Express service through St. Louis, American Eagle service through Dallas-Fort Worth, or Northwest Airline service through Memphis, so that even the fact that TWA does undoubtedly control Lambert Field does not impact the level of service that regional airline passengers see.

At most of the other major hub airports that are a far distance apart like Dallas-Fort Worth or Seattle, there is very intense competition among the code-sharing airlines.

We also heard some discussion of the fact that code-sharing might be a deceptive practice to the consumer. We don't agree with

that, obviously. The Department of Transportation does require that, in every oral communication between anyone selling a ticket and a passenger where there is going to be a code-sharing arrangement, that arrangement is described to the passenger. On the computerization systems, anytime you switch airlines you will see an asterisk so that the travel agents know that.

The code-sharing airlines are not called the same thing as the major airlines. They are United Express, TWA Express, the Delta Connector, American Eagle. The passengers know they are on a different carrier.

Let me make it clear, though, that it is the position of my association that we are always in favor of greater disclosure to the passenger. It is our experience that a happy passenger is a fully-informed passenger. We have never opposed any proposals to increase the level of disclosure to the passengers. Over all, we think that code-sharing has been a real plus for the rural passengers of this country, and we would hate to see this legislation disrupt that.

Thank you.

[The statement follows:]

STATEMENT OF JOHN E. FREDERICKSEN, PRESIDENT, REGIONAL AIRLINE ASSOCIATION

Mr. Chairman:

I am pleased to be here today to offer the views of the Regional Airline Association and its 32 member airlines on S-1761, the Airline Competition Enhancement Act.

Regional airlines provided scheduled airline service to 774 airports, and we enplaned over 37 million passengers, in 1988. In contrast, in the year prior to deregulation, we served only 470 airports, and carried only about 11 million passengers. In general, we believe that deregulation has been a very positive development, for consumers as well as for the airlines. A competitive, market driven environment has allowed the airline route system to grow until it is constrained not by economic failure, but by the efficiency of the infrastructure in which it operates. The Interim Five government economic regulation has enabled the regional airline industry to begin to play its part by offering high frequency service in airplanes technically designed to serve small and small communities. We are very concerned about legislative proposals to reimpose economic restrictions on the airline industry.

We believe that the proper role of the government is to regulate safety, and promote the development of the airport and airway system. At the last RAA membership meeting, in November, the

another airline voted to oppose any government regulation of the airlines, including the specific proposals contained in S-1761.

code-sharing

The DOT Secretary is particularly concerned about the provision of S-1761 which, if enacted, could severely disrupt the current structure of the U.S. regional airline industry. Fifty- one regional airlines are currently involved in a code-sharing relationship with a major airline. These fifty-one carriers comprise the bulk of the regional airline passenger carrying capacity, so that, while 161 regional airlines are currently operating in the United States, code-sharers carry 91% of the total passengers.

These code-sharing relationships range from outright ownership by the major carrier (19 airlines); to partial equity ownership by the major (6 airlines); to pure marketing alliances devoid of ownership by the major airline (26 airlines).

It is not clear from an initial reading of the proposed legislation whether or not a fully owned subsidiary of a major airline would be considered a code-sharer. Even those regional carriers which are fully owned by a major generally use a separate FAA operating certificate, often as a regulatory necessity because they operate smaller aircraft under different FAA rules. If a fully owned carrier would not be considered a code-sharer under the provisions

of S-1761, the effect of the bill would be to force major airlines to attempt to purchase their currently independent regional partners, or face major competitive disadvantages in relation to those major carriers with ownership control over their regional feed traffic. We do not believe that the drafters of S-1761 intend to promote the further concentration of the airline industry, but that would surely be one result of this legislation.

Code-sharing offers many benefits to the regional airline passenger. It features coordination of schedules and, thus, greatly enhanced scheduled connections between the regional and the major. It provides a single ticketing source which, in most cases, offers lower through fares that would otherwise be possible if the major and the regional operated totally independently. The single ticketing source, usually a computer reservation system, offers such amenities as through baggage check-in, advance seat assignments, and boarding passes for connecting flights. Another powerful, and popular incentive for the traveler to prefer the code-sharing service is the frequent flyer mileage which is usually available on the code-sharing regional flights. In even rural areas of the country, where the very existence of airline service is sometimes tenuous, the code-sharing relationship allows the regional carrier to tap into the major's advertising and marketing power to generate traffic, thus, helping to ensure the continued viability of service. When a regional airline passenger buys a ticket which includes a connecting flight on the major, the add-on

cost for the short haul segment of the trip is often much less than the regional airline would be able to offer as an independent. Banning code-sharing would, thus, cause an increase in airfares for regional airline passengers.

Competition among code-sharing regional carriers is extremely vigorous. That competition takes two forms, interhub and intrahub. In Springfield, Missouri, for example, a passenger has the option of TWA Express service through St. Louis, American Eagle service through Dallas Ft. Worth, or Northwest Airlink service through Memphis. In those areas of the country without strong interhub competition, intrahub competition is very strong. Seattle, with its strong competition between Horizon and United Express, or Dallas, with strong competition between American Eagle and the Delta Connection, are good examples of intrahub competition.

It is true that a new entrant carrier without a code-sharing agreement may have a competitive disadvantage beginning service at a hub airport. That competitive disadvantage does not translate into any disadvantage for the passenger, since, as I explained above, the code-sharing markets are all highly competitive. Recent experience has shown that those independent carriers can be successful by providing point to point service between smaller markets, bypassing the hub airports. Successful sharing carriers are continuing to thrive in many thin or remote markets which do not interest the major airlines, or in seasonal markets which cannot

justify a continuing code-sharing relationship.

Two major government studies have recently addressed the issue of code-sharing and its effect on competitive airline service. The Office of Transportation of the Department of Agriculture released a study in October of 1989 which found no data to demonstrate that codesharing had resulted in higher rural air fares. The Department of Transportation, in the Report of the Secretary's Task Force on Domestic Airline Competition, stated that the number of regional airline markets receiving competitive service may in fact have increased during the last few years.

CONSUMER CONCERNS

Some critics of code-sharing contend that the consumer is sometimes being misled when the regional airline and the major carrier with which it code-shares are not the same company. The regional airlines favor the greatest disclosure possible to the passenger when he buys a ticket. We believe that the current DOT rules requiring a passenger to be informed if he will be connecting on an airline different than the major carrier are adequate. Nevertheless, we have never opposed any proposals for more expensive disclosures of operators or equipment, since a better informed passenger is generally a happier one.

CONCLUSION

The concept of code-sharing was extremely controversial within the regional airline industry only five years ago. It is still not universally loved by the regionals, primarily because of the dynamics of partnership arrangements when one partner is dramatically larger than the other. Overall, however, the member airlines believe that code-sharing has been a real plus for our customers, the passengers, and an overall support relationship which would attempt to have both the small

STATEMENT OF JAMES E. JOHNSON, PRESIDENT, AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES, ON BEHALF OF AIRPORT OPERATORS COUNCIL INTERNATIONAL; ACCOMPANIED BY GEN. DON BENNETT, VICE CHAIRMAN, GOVERNMENTAL AFFAIRS COMMITTEE

Mr. JOHNSON. My testimony today is on behalf of the Airport Operators Council International and the American Association of Airport Executives.

On my far left is Don Bennett, Director of Airports, Lambert St. Louis International Airport and the Vice Chairman of AOCI's Governmental Affairs Committee.

For the sake of brevity, I will summarize our comments and ask that our full witness statement be included in the hearing record.

We want to thank you, Mr. Chairman, for holding these hearings. The issue of airline concentration and competition has become a growing concern to airports throughout the country, and we are pleased to have the opportunity to express our concerns today.

We also commend Senators Danforth and McCain for introducing S. 1721 and generating a much needed debate about the impact of diminished airline competition on the present and future air transportation system. We believe that the trend toward increased airline industry concentration is serious and that immediate actions needed to enhance competition and preserve the spirit and benefits of the regulation.

As public officials, our members have a direct interest in expanding airline service to and from their communities and ensuring that passengers and shippers have competitive service and fare options. Of course, much of the concentration we now see stems from many airline mergers, consolidations and bankruptcies that has occurred in recent years. While we are not here to second guess the Department of Transportation's handling of mergers and acquisitions, we do believe that government must be more vigilant in reviewing mergers within the industry to prevent any further concentration or decline in competition.

As you and many Members of this subcommittee remember, a principal issue in the debate that led to deregulation of our airline industry was its high level of concentration. In just over a decade, the industry has gone from highly concentrated to open entry all back to highly concentrated.

Does this current state of the airline industry warrant deregulation? We believe the answer is no. Deregulation has provided real benefits to the Nation, and the hub and spoke system that has emerged has been a key factor in allowing airlines to operate more efficiently and to offer greater service options to the traveling public. We wish, however, losing the benefits of deregulation when one or two carriers can dominate a hub airport to the point where even a potential for meaningful competition does not exist.

Currently, at 11 of the top 50 airports one carrier emplanes at least 50 percent of all passengers, and at seven airports one carrier alone handles more than 70 percent of all the passengers boarding. Studies reveal that the yields of the dominant carriers are significantly higher than local passengers than from passengers who or

nect through the same airport. This raises the question about whether carriers which dominate specific airports are pricing local fares higher because of inadequate competition.

Let me emphasize that this is not an argument against hubs. It is an argument for making sure that there is competition or at least the opportunity for competition at hub airports. In theory, deregulation permits competitors to move into noncompetitive markets. However, it is not easy to start an airline these days. Some of the factors that are perceived as creating the greatest potential barriers to open competition and remedies for these obstacles have been identified in S. 1741.

While we are not in a position to address some of the specific remedies in this bill, we do support their intent. The concept of reversing the burden of proof in cases of extreme concentration is an attractive philosophy, as it provides the incentive for a dominant airline to avoid overconcentration. We would also mention our members' support for code-sharing as a benefit to small community air service.

The barriers to entry we would like to focus on today are ones that airports can help overcome if Congress will permit us to do so. The lack of airport capacity in general is a contributing factor to our current competition and air service problems.

Today it can be very difficult for a new entrant or an existing carrier to obtain access to airport facilities that are critical to the start-up or expanding of service. DOT's buy-sell rule has certainly compounded capacity problems systemwide by creating obstacles to new entrants and growing incumbents seeking access to the four major airports under this rule.

We believe buy-sell in the high density rule itself should be revisited in order to develop a more equitable market-based method of allocating slots. To the extent slots are reallocated, the proceeds should be designated for airport capacity enhancements.

Another serious constraint to market entry is the lack of competitive gates. Our recent survey revealed that competitive gates from the 30 largest U.S. airports for new airline service are extremely scarce. These 30 airports explane nearly 70 percent of all domestic traffic and represent some of the most attractive markets for a prospective new entrant carrier to enter. If gate facilities are not available directly from the airports, new entrants would most likely have to seek subleasing arrangements with competing incumbent airlines to obtain these facilities. However, subleasing requires the new entrants to negotiate terms and fees with an incumbent carrier who can choose to deny access to a potential competitor or impose charges and terms that disadvantage the new entrant.

Further compounding a lack of available existing gates is the large degree of control that incumbent airline exercises over airport's ability to fund and construct new gates. Majority-in-interest clauses and similar provisions commonly found in airport airline use and lease agreements can give airlines effective control over the construction, financing and assignment of new gates and airport development is granted. Twenty-five of the 30 largest airports have at least one such restriction in their airport use and lease agreements. This indicates that the incumbent airlines have con-

siderable power and persuasion over airport development, particularly capacity enhancement projects.

Many of the current constraints to increasing capacity could be overcome if airports were given the flexibility to become more self-sufficient. While the current airport improvement program has been beneficial to airports, it has not provided enough funds and flexibility to build the new capacity enhancements. Gates, for example, are ineligible for Federal funding. One solution to the overall capacity crunch is for Congress to return to airports the authority to assess a modest charge on air travelers using their facilities. Prior to 1973, airports had such authority; however, when deregulation was enacted the Federal prohibition on local passenger facility charges was not repealed, and the local and State governments responsible for financing our Nation's airports were left with limited resources to meet growing air traffic demands. A passenger facility charge, more commonly known as PFCs, would allow airports to increase capacity and build new competitive facilities and thus provide their communities with new service opportunities.

We believe the approach taken in S. 1741 would be very beneficial for competition by permitting concentrated hub airports to impose PFCs subject to DOT approval; however, we also believe that all airports should have PFC options. Over the next five years, an estimated $50 billion will be required to finance airport improvements.

Mr. Chairman, we understand your concerns regarding PFCs and the need to spend the aviation trust fund surplus for its intended purpose. We, too, want to see the trust fund provide more dollars for airport capacity, and our two associations remain committed to working with you as you continue your valiant effort to reform the FAA and the current budget process.

In conclusion, AAAE and AOCI believe that S. 1741 is a positive approach in addressing the problem of concentration. The PFC and slot allocation provisions in particular are perhaps the best way to remedy the current problem while preserving deregulation. They at least would give airports the tools to do our part in preserving and promoting competition.

Both Don and I would be happy to respond to any questions.

[The statement follows:]

TESTIMONY OF THE AIRPORT OPERATORS COUNCIL INTERNATIONAL AND THE AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES BEFORE THE SENATE SUBCOMMITTEE ON AVIATION ON AIRLINE CONCENTRATION AND COMPETITION AND S. 1741 APRIL 9, 1998

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify today on behalf of the Airport Operators Council International (AOCI) and the American Association of Airport Executives (AAAE). AOCI represents the local, regional and state governing bodies that own and operate the principal airports served by scheduled air carriers in the United States and throughout the world. AAAE is the professional organization representing airport executives who are responsible for the planning, management and operation of airports nationwide.

We want to thank you, Mr. Chairman, for holding these hearings. The issue of airline concentration and competition has become a growing concern to airports throughout the country, and we are pleased to see that you are looking into it. We also commend Senators Danforth and McCain for introducing S. 1741 and generating a much needed debate about the impact of diminished airline competition on the present and future air transportation system.

AOCI and AAAE believe that the trend towards greater airline consolidation and reduced competition are serious and that active steps are needed to enhance competitive opportunities and preserve the benefits of deregulation. As public officials, our members have a direct interest in expanding airline service to and from their communities and providing competitive service options and affordable fares for passengers and shippers. Aviation growth is critical to the economic vitality of our communities. In addition to the direct benefits afforded travelers and shippers, a growing local air travel market also translates into more jobs, greater tourism and many other economic benefits which contribute to a healthier local economy. That statement is not unique, however, when competition and expansion are enjoyed as artificially constrained.

The first step is to identify the extent of the problem and its effects on competition and air fares in the industry. The information you are gathering through these hearings is shedding much needed light on the subject. A number of factors, including the Department of Transportation and the General Accounting Office are examining the issue and its impacts. These data and studies certainly show that problems do, in fact, exist and give all of us reason to believe that it must be addressed by

Congress. ADCI and AAAE have also examined this issue from the perspective of airports and their communities, and we have some insights to offer which I will discuss a little later.

While the scope of the problem is not fully known, the current situation and emerging trends should rightfully concern this Committee. Some facts are indisputable: one, there are far fewer air carriers today than at any time since airline deregulation. Only five of the 77 new airline entrants that existed following deregulation still exist today. Two, the market share of the five largest carriers has grown substantially at many airports. At seven major airports, one carrier now handles more than 75% of all passenger boardings.

Of course, much of the concentration we now see stems from the many mergers, consolidations and bankruptcies that have occurred in recent years. We're not here to second-guess DOT's handling of mergers and acquisitions. However, we do believe that, given the present situation, the government must be much more vigilant in reviewing any further mergers within the industry to prevent further concentration or decline in competition.

RE-REGULATION IS NOT THE SOLUTION

We also want to caution against efforts to re-regulate the airline industry. That is not the answer to our current problems. Deregulation has provided many benefits to the nation and air travelers; not the least of which are better service to more places and generally lower fares, which have largely contributed to the growth in passenger levels and air traffic. More people are flying because of deregulation and we should not turn back the clock. The hub-and-spoke system that has emerged since deregulation has also been a key factor by allowing airlines to operate more efficiently and to offer greater service options to travelers. Hubbing has been beneficial for air travelers, specific airport communities and the nation as a whole.

However, we must be concerned with the prospect of one or two air carriers dominating a hub airport to the point where even the potential of meaningful competition does not exist. We risk losing the benefits of deregulation if we don't take steps to address concentration and to promote competition.

Competition is essential to keep our dynamic, free market system in balance. Adequate competition allows those who have dominant control of a market to exploit customers, and increases the risk of anticompetitive practices.

Data prepared Wilbur and published by Airline Economics, Inc. (enforcement) [illegible] that at hub where merged carriers enplaned at least 50 percent of total passengers, the yields of the

"dominant" carriers are significantly higher from local origination and destination passengers than from passengers who connect through the same airport. Currently 11 of the top 30 airports have one carrier which enplanes 50% or more of all enplanements. This raises questions about whether carriers which dominate specific airports are pricing tickets and receiving higher yields from the local origination and destination (O&D) passengers because of inadequate competition.

Let me emphasize that this is not an argument against hubs, it is an argument for making sure there is competition, or at least the possibility of competition at hub airports. In theory, deregulation permits competitors to move into non-competitive markets. However, it is not easy to start up a new airline these days. It can also be very difficult for a new entrant or an existing carrier to obtain access to airport facilities that are critical to start up or expand service.

AIRPORT CAPACITY PROBLEMS AND FUNDING NEEDS

As a result of the great increase in air travel and cargo shipments which deregulation has produced, our nation faces a crisis in aviation congestion. In 1987, U.S. airports enplaned 471 million passengers; by the year 2000, FAA forecasts that this will grow to 820 million, an increase of 74 percent, and that aircraft operations will increase by 33 percent.

In 1987, 21 major airports were considered by FAA to be "seriously congested," that is, they each experienced more than 20,000 hours of delay annually (an average of 55 hours of aircraft delay every day), while some had over 100,000 delay hours. Barring major improvements in airport capacity, FAA estimates that about 40 airports will be seriously congested by 1997, affecting 60 percent of all air passengers. These delays are costly. FAA estimates that each 20,000 hours of delays costs the airlines $32 million, and that airlines and passengers are paying $4-6 billion due to increased operating costs and lost time. To put it in layman's terms, as one congressman did recently, if we don't do something to improve airport capacity soon, every day will seem like the day before Thanksgiving at our nation's airports.

The lack of airport capacity in general is a contributing factor to our current competition and air service problems. We simply have not built enough facilities to keep pace with the dramatic growth in traffic and passengers. I don't have to tell this Committee about the shortcomings of the Federal airport improvement program, which has been inadequately funded to meet pressing airport expansion needs. Airport capital development needs are growing, as evidenced by the recent additional capital needs survey which reveals that airports nationwide require $57 billion in funding between 1991 and 1995 for essential and needed

capacity enhancement projects and facility improvements (see Attachment 2.) The FAA has also identified similarly dramatic airport capital needs over the next five years. Clearly, the AIP program and existing airport funding sources will fall far short of meeting a $10 billion annual airport funding need.

BARRIERS TO ENTRY

Airport capacity constraints serve to limit the potential for new and expanded air service. Other "barriers-to-entry" have been identified in various competition studies. These include the sheer market power of the dominant carrier already entrenched at an airport, which can temporarily undercut prices to stave off new competition, frequent flyer programs and airline-owned computer reservations systems. These are among the tools that incumbents air carriers can employ to maintain their dominant position and effectively block new competition. S. 1741 addresses many of these. We are not in a position to endorse the specific remedies called for in some provisions in S. 1741 with regard to these issues, but we do support their intent. The concept of reversing the burden of proof in cases of extreme concentration is an attractive philosophy, as it provides the incentive for a dominant airline to avoid over-concentration. We would wish to mention our members support for code-sharing as a benefit to small community service. For many small communities, particularly those in the essential air service program, code-sharing has helped improve service, frequency, and reliability by creating on-line service and convenient connections. A variety of service enhancements, such as special baggage handling, use of the same computer reservation system, and through seat assignments, have been made available to the traveling public through the use of code-sharing. Without this unique marketing arrangement, it would not be economically feasible for the commuter carrier to market their service in distant cities. We would like to focus on barriers-to-entry which airports can help overcome, if Congress will permit us.

SLOT DENSITY AIRPORT RULES

One barrier-to-entry which bears directly on the slot system at the nation's four high-density airports, which, since 1969, has restricted the number of landings and takeoffs, DOT's "buy-sell" rule recommended capacity problems at the four high density airports by giving some valuable slots to incumbent carriers. Buy-sell has created obstacles out of proportion to the effective and orderly incumbents seeking access to those airports, and effects not only those four airports, but many other markets which could be served from those airports. Obtaining slots because the existing airlines for a carrier seeking to serve those markets, which by definition, have greater demand for service than the system currently allows.

new entrants have at times paid billions of dollars to incumbents for slots for which those incumbents paid nothing. This obviously places the new entrant at a severe competitive disadvantage. In other cases, new entrants are unable to purchase a slot at any price -- they are simply "not for sale". ACCI and AAAE believe that the "buy-sell" rule, and the high density rule itself, should be revisited in order to develop a more equitable market-based method of allocating slots.

To the extent slots are reallocated through an option, the proceeds should be designated for airport capacity enhancement. Incumbent slot holders should not be permitted to sell their slots for corporate profit. Slots should be reclaimed and held in the public domain where they belong.

[illegible] AIRPORT GATE AVAILABILITY STUDIES

Another serious constraint on market entry we would like to focus on is the lack of available and competitive gates, which are critical to preserving and promoting airline competition. We conducted a survey of our U.S. airports last year to determine the availability of "competitive" gates. We have also gathered information on the degree of airline control over airport development through use and lease agreements at large airports in the United States.

Our gate availability survey [illegible] It was based on a hypothetical situation in which a U.S. air carrier is seeking to start service to the airport. The new entrant's request for "competitive gates" presented the airlines start-up service requirements as follows:

> "The start up of service will at first require at least three gates in your busiest peak hour, none of which may be remote and all of which must be able to handle at least a B-737/A-319 type aircraft. All flights must be turned around in one hour."

The three gate specification is the bare minimum required to start up a small hub. Typically, an airport needs at least five gates to start up a hub operation. An airline needs at least one full-service gate to serve an airport in a minimal fashion, as a spoke.

For the purpose of the survey, a "competitive gate" was defined as the combination of the five terminal facilities necessary to provide airline service: aircraft parking position, passenger loading and unloading facilities, passenger hold room, passenger check-in counters, bag make up and operations space, and baggage claim facilities. It was emphasized that all of these facilities had to be available from the airport operator on competitive terms and non-exclusive.

This strict definition assured that gate facilities and related services could be provided on a truly competitive basis, under the same conditions and terms as are available to incumbents, and that no component could be manipulated by a competing interest. For instance, if gates are subleased or ground handling services are contracted from an incumbent carrier by a new entrant, the terms often include short notice recall provisions, higher rates and fees or a lower service quality which can put the new entrant at a competitive disadvantage vis-a-vis the incumbent carrier.

It is important to note that, at some airports, a new entrant airline may be able to obtain gate facilities on a competitive basis from an incumbent airline, such as through subleasing. However, because there is no assurance that the new entrant could obtain such gates, or sublease them on competitive terms, gates that may be available only by agreement of an incumbent airline were not considered "competitive" or "available" in our survey.

The key findings relate to the potential of airports to provide competitive gates during the peak hour. The results for the 30 largest U.S. airports revealed that competitive gates for new airline service are extremely scarce. These 30 airports enplaned 320 million passengers in 1987, nearly 70 percent of all U.S. traffic. Undoubtedly, these airports represent some of the most lucrative markets for a prospective new entrant carrier to enter.

Out of a total of 2,495 gates at the top 30 airports, only 51 gates, or two percent (2%), could be made available during the airports' peak hour. Even when we examined gates that could be made available at other hours or within six months of the entrant's request, with the exception of one airport, only a small number of additional gates could be made available.

Only five of the airports surveyed could provide the three gates necessary for our hypothetical airline to start service. If the minimum number of gates assumed to be necessary to start a hub were increased to five, only three airports could meet this requirement. Nineteen airports indicated that they could provide no gates.

At this point, I should note that it is not surprising that the top 30 airports do not have much excess capacity. The current legal and financial arrangements under which most airports operate make it imprudent for airport managers to "overbuild", or build more capacity than carriers have firmly committed to. However, given the capacity crunch that is threatening to stifle our national economy, it is time to consider changing some of the financial and legal restrictions on airports so that it becomes prudent for airport managers to build capacity early, rather than later. I will elaborate on this later in my discussion of the passenger facility charge.

Since airport terminal facilities and services must be available and assignable on a competitive basis to provide potential new entrants equal access to markets, the gate survey findings indicate there is little opportunity for new entrants to start a competitive multi-airport route network.

If competitive gate facilities are not available directly from the airports, new entrants would most likely have to make arrangements with competing incumbent airlines in order to gain access to most airports. This would require subleases under which the incumbents may command higher rates, fees and charges; ground handling and other service requirements (such as fueling, towing, baggage control, food service, & maintenance); and short notice recall.

Such sublease requirements would increase the new entrant's economic costs through the imposition of premium charges and/or by a potential lower service quality because of its dependence on the incumbent airline's personnel for essential services. Thus, the ability of a new entrant to provide true competition to the incumbent is substantially constrained.

AIRLINE LEASE CONTROL OVER AIRPORT CAPACITY DEVELOPMENT

Airport terminal facility areas have been traditionally leased to airlines on a long-term exclusive-use basis, usually 15-30 years. Exclusive use means the assignment of facilities to a particular signatory airline for its sole use in providing specific aviation services.

Many airport leases contain "majority-in-interest" (MII) clauses which give the signatory carriers approval over major capital improvements, such as new runways or terminals, or major expansions or renovations. The ability of an airport to increase gates and related facilities and add capacity for new carriers is often constrained by lease agreements and contractual provisions with its incumbent carriers. In their competition studies, both DOT and GAO have identified MII clauses as one of the most significant constraints to new entrants. Concern arises over the extent to which "majority-in-interest" clauses give incumbent carriers not only substantial control over the use of existing facilities, but over the development of new facilities as well. MII clauses can cover the airfield, terminal or both. The definition varies from airport to airport, but is usually based on percent of operations, landed weight, enplaned passengers or terminal space rented. The degree of control varies from requiring airline review of planned projects to complete veto power over airport capital improvement projects. Such controls, in some cases, can become de facto barriers to entry for new competitors.

At many airports, the incumbent airlines have virtual veto power over the construction and financing of new facilities. These leases, many of which were entered into before deregulation, have become a two-edged sword. They give the airport assurances of the airline's commitment to the airport, and a guarantee of revenues to enhance the airport's ability to issue bonds for financing capital improvements. They also give the airline a degree of control over the airport's actions in exchange for its financial commitment. However, these lease provisions can also inhibit efforts to build new capacity that would benefit the local community and enable a potential airline competitor to start or expand service and offer competitive fares and service choices for the consumer.

Compounding the lack of available gates is the large degree of control incumbent airlines exercise over an airport's ability to fund and construct new gates and new capacity. Requirements for airline approval of any of the following can give airlines effective control over construction and assignment of new gate capacity:

- o projects above a certain cost;
- o adjustment of the landing fee to pay debt service;
- o adjustment of terminal rentals or use fees to pay debt service and operating costs; and
- o bond sales to fund new gate capacity.

Two other types of contract provisions which can inhibit an airport's ability to raise funds from airline users to cover capital costs are:

- o clauses which prevent the airport from charging "additional rates, fees and charges"; and
- o clauses that prevent the airport from changing its method of calculating its landing fee.

Since any of these restrictions can effectively stifle an airport's ability to pursue needed capital improvements, it is important to consider them in combination. Twenty-five of the 30 largest airports (or 83%) have at least one of the above airline/airport use and lease agreement restrictions. This indicates the incumbent airlines have considerable power and suasion over large airport development, particularly capacity enhancement projects.

Thus, you can see that the gate availability survey indicates that competitive airport gates are extremely scarce and that the airlines have a high degree of control over airport capacity enhancement and capital development. Our hypothetical new entrant who could not obtain adequate gates directly from the airport or sublease gates from an incumbent on competitive terms, would have little choice but to ask the airport to build new

gates. But there again, that option may not be viable if the incumbent airlines fear competition and thwart new construction through their contractual controls.

AIRPORTS NEED LOCAL FUNDING OPTIONS TO PROVIDE NEW CAPACITY AND COMPETITIVE FACILITIES

It should be noted that, under the current statutory criteria, the elements that we have identified as comprising a competitive gate would be ineligible for federal Airport Improvement Program (AIP) funding, even if such funding were available in sufficient amounts.

One solution to the overall capacity problem, and particularly the lack of funding for gates, is for Congress to return to airports the authority to assess a charge on air travelers using their facilities. By giving airports the option of assessing what has become known as a local passenger facility charge, or PFC, Congress would be taking an important step in providing the additional funding source airports need and enhancing the ability of airports to finance and build capacity projects. It would empower airports to increase capacity and build new competitive facilities, and thus provide their communities with new service opportunities by new entrant carriers, as well as incumbents.

The PFC would also enable airports to become more self-reliant by enhancing their ability to finance projects through the bond market. An independent local revenue source, such as a PFC, can be leveraged to dramatically increase bonding power. We have attached to our statement (Attachment 4) a comparison of the amount of funds airports now receive through AIP entitlement funds, and the funds that could be raised through a modest local passenger charge coupled with greater bonding power. This would provide the means for a significant expansion of airport capacity nationwide, which all aviation groups agree is critical to future growth of our national aviation system. PFCs can provide a stable and substantial stream of revenues that airports of all sizes can use to repay debt service and thus obtain better access to the bond market for the capital funds they need.

We are currently meeting with aviation groups, including the airlines, in an effort to address legitimate concerns they might have on the implementation and use of a PFC. AOCI and AAAE are firmly committed to the notion that any funds generated by a PFC must be spent only for airport capital development projects -- for projects that enhance capacity, security, safety, or noise mitigation -- and for developing new airports. (Attachment 5) PFC revenues could also be very beneficial to finance the expansion of general aviation and reliever airports, where such projects would help relieve congestion at the primary airport.

We believe the approach taken in S. 1741 would be very beneficial for competition, by permitting "concentrated hub" airports to impose PFCs, albeit subject to DOT approval. However, we would recommend that a broader provision allowing all airports the local option of imposing PFCs would be the best way to assure system wide capacity to solve problems before an airport becomes concentrated. This would enable airports to finance the construction and expansion of new facilities and gates that are needed by both new entrants and incumbent carriers which need to expand. Expanded airport facilities are critical to providing competitive opportunities and, most importantly, the threat of new competition which is essential to assuring competitive air fares.

If the federal government cannot provide the substantially higher funding that airports need, then it is incumbent on the government to at least give local airport authorities the means to raise funds from passengers who demand and need better facilities, reduced delays and the benefits of competitive air services.

In this era of ever-tightening federal budgets, an especially attractive feature of the PFC option is that it has zero impact on the federal budget. Congress thus has the opportunity to promote needed infrastructure development, which will have benefits multiplied throughout the economy, without exacerbating the federal deficit. The other advantage is that by keeping these funds locally, they will not be tied up in the federal budget and appropriations process. Thus, they will provide a reliable source of revenue that airports can count on for facility planning and capacity expansion. We think this is a "win-win" situation for all parties.

In conclusion, AOCI and AAAE believe that S. 1741 is a positive and necessary approach to airline industry competition problems. The PFC and slot allocation provisions, in particular, are perhaps the best way to remedy current problems while preserving deregulation. They at least would give airports the tools we need to do our part in preserving and promoting competition and enhanced air service. We strongly urge the Committee to consider local airport passenger charges as you study possible solutions to the concentration problem, as well as means of funding needed airport development. Thank you.

Senator FORD. Thank you, Mr. Johnson.

I am going to pass now to my distinguished friend here, Senator McCain. We are all pleased that Senator Danforth is back, Mr. Fredericksen. I am going to give up my time now so we can get to them quicker.

Senator MCCAIN. I look forward to that exchange, too, Mr. Chairman, and I am sure Mr. Fredericksen does, too.

Mr. Mathias, I understand you have a unique problem here. I frankly do not have any questions for you. I understand that it is critical to the continued successful operation of Pan American that they preserve their slots, which they did pay for.

I would remind you that the vast majority of slots were not paid for but were received for free. As you know, they were a government asset, and now they not only can be sold but can be leased, which I find very difficult to understand.

I would like to say to you, Mr. Mathias, that you and other airlines who find yourselves in a situation where they made a substantial investment in a slot that it is not the intent of this sponsor of the legislation to deprive you of a very valuable and, in fact in your case, perhaps critical asset. So I hope you understand that when we continue to address the various aspects of this legislation.

Mr. Hoeksema, first of all, congratulations on being one of two post-deregulation airlines that survived. I saw you on some program one night where you described how you did it, and I think it is an example of entrepreneurship and tenacity that is certainly exemplary.

Basically this is for the record because I know the answer. Would you basically enumerate just how an airline can own a computer reservation system and put you at a competitive disadvantage?

Mr. HOEKSEMA. There are a couple of aspects to that. First of all, inaccurate data. We have had examples. Just to give you one example, a passenger in Albuquerque who flies frequently between Denver and Milwaukee has repeatedly not been able to find us in the computer reservation systems of the travel agents in the Albuquerque area. Upon talking to the CRS vendor, they said this was an oversight and they would correct it. That type of thing happens on occasion.

I will give you another example. When we started service to Kansas City last year, it takes from 10 to 15 days from the time we give the information to the CRS vendor for that information to be loaded. The owner of the system can load theirs right away. There is quite a delay for us.

We announced our service to Kansas City, and after we waited for that week or week-and-a-half delay we monitored our bookings. They were not picking up very rapidly. The bookings from the Milwaukee side to Kansas City were doing well, but from the Kansas City side to Milwaukee were not doing well. We were a little surprised by that because we figured we had gone into a pretty good market and we had done our homework.

After about an additional week and a half, we checked and found out by calling a bunch of travel agents in the Kansas City area that we were not displayed at all. We called the CRS vendor, and through an oversight we had not been loaded at all in that particu-

lar market. Once they corrected that and loaded us, our bookings began to increase significantly.

So inaccurate data and delays in display are certainly ways that from a small carrier perspective provide a disadvantage for us. I think there are excessive costs. In addition, in a host carrier there is a loyalty and a bias built in, not that that is all particularly bad, but the host carrier has the ability to look at our and the competitors' bookings. They can see, for example, that a competitor's bookings on a particular flight are building up and getting full, and they can then increase their fares on that competitive leg. It certainly is an advantage for them which somebody like us does not have.

Senator MCCAIN. Mr. Crandall says, Mr. Hoeksema, that he invested in a CRS when nobody else would. Should we punish him?

Mr. HOEKSEMA. Certainly philosophically I would like to think that there is a way to avoid requiring divestiture. Certainly somebody who invests money in something should be able to reap the returns, and if there was a way to do that through monitoring and regulation I would think that would be a better choice.

Our experience over the last several years has not indicated that that monitoring and regulation system is sufficient, and if that could be changed that might be a better alternative at this point in time. We have not seen the positive impacts of that regulation.

Senator MCCAIN. Mr. Johnson, thank you for your testimony. I think it is a very comprehensive statement and one with which I have no question. Thank you for being here.

Thank you, Mr. Chairman.

Senator FORD. Senator Kasten.

Senator KASTEN. Mr. Chairman.

Mr. Mathias, you looked as though you wanted to respond to the same question as Mr. Hoeksema in terms of the computer disadvantage and trying to deal with the computer problems. I have other questions, but I want to give you a chance to fill out this part of the record if that is what you would like to do.

Mr. MATHIAS. I was just nodding in agreement, of course, completely with him and with the testimony of Mr. Davidoff of ASTA that has been put in with resect to the different ways that the nonvendor carriers are disadvantaged by the system.

It is really not a fair way to put the question to ask whether Mr. Crandall and the investment that he wisely made should now be punished or to wipe out his investment. What we are really trying to do is solve the abuses of it. It is possible through effective and energetic DOT regulation to do that. It would appear that over the past few years we have not seen that kind of energetic supervision of the CRS systems despite the DOT's own study about grossly excessive prices to carriers like Midwest Express and Pan Am and America West and despite other abuses involving the leasing of CRS systems, et cetera.

So whatever this committee could do if it does not pass CRS legislation, punishing Mr. Crandall at least could put him back on the reservation where we all get a fair shake.

Senator KASTEN. If you were going to divest, it would not seem that we would necessarily punish him. That is a profit center right now for that airline. That company would be put up for sale, and a

number of people who buy it. His investment would be rewarded, it seems to me.

Mr. MATHIAS. That is true.

Senator KASTEN. He would not be operating it out in the future because of the abuses.

Mr. Hoeksema, I understand from your testimony why Midwest Express has not been able to purchase slots. You talked about the fact that they were not for sale. What about leasing? Are slots available for lease?

Mr. HOEKSEMA. There are a few slots available for lease. We have leased two slots each from two different carriers. As was testified to earlier, normally those periods are relatively short, six months or less, and it is very impractical for a small carrier like us to introduce and tool up for a brand new service into a slot-controlled airport and six months later we are out in the cold. So it really becomes a fairly impractical thing for a new entrant or a limited incumbent carrier.

Senator KASTEN. You mentioned that four slots were not sufficient to serve a particular market, and you suggested in your testimony that 12 would be sufficient.

Is 12 the minimum or is 12 the number that you would like? Could you explain to me the problems with four and why 12 is the right number and the problems of operating at those various numbers?

Mr. HOEKSEMA. First, I did not mean to imply that you could not operate with four. We have been operating at National and at LaGuardia for some time with four slots which gives you two flights in each direction per day. It certainly is not an optimum thing. It is not an efficient thing. You have an investment in people and equipment and all at that at the airport. You must serve the entire day. You cannot have both of your flights in the morning or both of your flights in the afternoon if you want to really attract your market.

So you have to have people there all day long, and it is very inefficient. We want to have our own people. Midwest Express has the reputation of providing a good quality service. It is important to us that we have our own employees that are trained in our system to meet the public, so it becomes a very ineffective and inefficient system when you only have two flights a day.

Another factor in terms of minimum number of flights is that passengers prefer to travel on a carrier that can provide a choice of flights in a market. It is ironic that in 1989 Midwest Express was denied an opportunity to provide transportation to government employees because Midwest Express did not have sufficient frequency of service between Washington National and our hub in Milwaukee to meet the minimum frequency standards of the General Services Administration for that market.

Midwest Express could only offer two flights each way because of the FAA slot restrictions. GSA requires a minimum of four each way. Midwest Express was denied the government contract despite the fact that we offered air fares 8 percent below the fares of the airline that received the government contract. This is a graphic example of how the public pays the economic consequences of an FAA policy that has protected entrenched large carriers.

Senator KASTEN. Do you know why GSA has that policy? I just learned something. Is the idea that they do not want you to have to stay overnight if you miss one flight? They want there to be at least the minimum number so that would force the Federal employee to stay overnight? Is that why they have the policy that you have to have at least a certain number of flights?

Mr. HOEKSEMA. That is right, and the traveling public thinks the same way. They like to fly on a carrier that has a number of options. If their meeting is late and they miss that flight, they like to have options later in the day. So it is very important from a marketing point of view.

Senator KASTEN. I have just one final question regarding not the slots but the gates and the services.

Can you elaborate on problems that limited incumbents or new entrants have encountered in obtaining gates and services at major airports, and is there a way that we can remedy some of these problems?

Mr. HOEKSEMA. I briefly alluded in my comments to two aspects of the problem. One is long-term leases on gates that large carriers have. In some cases, for example, when we began service to Los Angeles just over a month ago, we were informed that some gates in a particular terminal there were underutilized but they were under long-term lease to a major carrier and consequently were not available to us.

The other part of that is there are gates that the airport authority has, and they are not subject to lease to anybody else, but for some reason they have chosen not to lease those out to us. For example, also in Los Angeles there was a gate that had been recently vacated by Braniff that was not subject to any lease but the airport refused to allow us to use the gate because of what they felt was terminal congestion and the fact that some of the carriers in that terminal may want to use that gate at a later time. So it has really been difficult for us to get gate space.

I might add that we estimated last year we spent an additional $1 million because of costly handling fees by being handled by other carriers where gate spaces were not available for us, and it was $1 million more than had gates been available and had we done that handling on our own.

In terms of remedies, I think it is a difficult question. Certainly if there was a system where a certain amount of usage had to be required, if there were a number of gates that were under long-term lease with a major carrier and there was underutilization, it would be helpful if there was a mechanism that some of those underutilized gates could be made available or have those leases terminated somehow.

Senator KASTEN. Mr. Chairman, thank you.

Senator FORD. Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman.

Mr. Chairman, accompanying Mr. Johnson is General Bennett, who is the director of Lambert in St. Louis, and I would like to ask him a question if I might.

Senator FORD. He is available.

Senator DANFORTH. General, the question is, of course, about Lambert. Let us say that we do not act on the PFC issue and that

passenger facility charges are not created and that, therefore, Lambert is not able to put one in place.

What would be the effect on Lambert with respect to expansion, and what would be the possibility of getting new entrants at Lambert? Then more generally with respect to the whole St. Louis area, what, in your opinion, would be the effect?

General BENNETT. Since deregulation, Senator, the enplaned passengers at Lambert have doubled, and they are forecast to double again within the next ten to 15 years. We are a physically constrained airport in that our runway configuration will not accept those types of increases; therefore, we must expand Lambert Airport in order to take advantage of that. I say we must expand it because the economic impact on the whole area has also doubled during that period, the benefits that are derived from having a large hub airport.

If the PFC is not enacted, the expansion program which we forecast to cost somewhere in the neighborhood of $1 billion would require a fourfold increase in the landing fees of the airlines operating out of Lambert, and that would be a sudden increase, a fourfold increase. We currently charge approximately $1 per thousand pounds of landed weight. That would go to approximately $4 and maybe even higher in order to do that.

In order for us to achieve a fourfold increase or any increase for that matter in landing fees, it requires the acceptance and agreement of the airlines operating there. In our majority-in-interest agreements, the airline that lands the majority of the weight, which is TWA which dominates us to the tune of 82 percent, does have a veto power over any increase in landing fees. So it would be basically we would have to ensure that TWA would accept, as well as the other airlines, a fourfold increase in landing fees in order to do that. That would provide the revenue stream to go to the bond market in the traditional manner with the revenue bonds to build the airport.

With a PFC, it would require, as the PFC is outlined in the current administration bill, a very modest increase in the landing fees, and the rest of it could be paid by the PFC.

Now as far as what would happen to the whole area, it is vitally important that we do——

Senator DANFORTH. How about new entrants first?

General BENNETT. New entrants? I have no room for new entrants today. Every single gate I have is occupied and will be occupied up until the year 2005. The airlines can trade these gates like they do slot times or anything else. I have no control over them. If I have to build new gates, I can build a minimum number, about approximately 10 gates which will not provide any meaningful competition to anybody, ten new gates at Lambert. Currently, TWA has approximately 46 gates, and ten new gates would do nothing.

So I really cannot accept new entrants at this time. Not only the gates, but I do not have the runway capacity to increase the number of airlines coming in. Simply, the airport must expand.

Senator DANFORTH. Now the area that you were beginning to talk about?

General BENNETT. The economic impact on the Greater St. Louis area is quite significant. ATA ran a study about three or four years ago that said that Lambert had about a $2 billion annual impact on the local area, and recent studies we have completed are going to show that that is very, very conservative, to the tune of about two to one. We feel that it is closer to about a $4 billion annual impact, and if the airport is expanded, that economic impact will continue to grow up to maybe $8 to $10 billion in the next 10 to 15 years.

It has a tremendous impact on the local area. It provides jobs, and it provides a great economic thrust.

Senator DANFORTH. If there is no PFC?

General BENNETT. Again, the expansion of the airport will depend upon the agreement of the airlines. It can be done, but they must agree to it. With the PFC, we can do it independently.

Senator DANFORTH. Do you think it is likely that TWA would agree?

General BENNETT. Given TWA's current financial position, I cannot speculate on that.

Senator DANFORTH. You believe, therefore, that without a PFC there would be no expansion?

General BENNETT. I cannot say there would be none, sir, because TWA might very well agree to it, reluctantly.

Senator DANFORTH. Would you say that the possibility of expansion would be in serious question if there were no PFC?

General BENNETT. Yes, I would say that, sir.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. What about code-sharing?

Senator DANFORTH. This is what is called the sucker punch. Not having had the benefit of hearing your testimony, this is Lucy's football that has just been put before me by Senator Ford, and I am going to fall for it. I do not know what you said, but do it to me.

Senator FORD. In the words of a great statesman, relax.

Mr. FREDERICKSEN. Let me do it this way. I will just answer a couple of the questions, if I can, that you presented to Mr. Shane from the point of view of the people who are in the business of code-sharing.

You asked whether or not code-sharing presents a competitive advantage. The answer is absolutely yes. Anytime you provide more convenient service for less money to a passenger, that is going to provide you a competitive advantage. The way the airlines compete with each other in Missouri, as I mentioned, is they have interhub competition. Northwest Airline flies through Memphis to many communities in Missouri. American Eagle flies through Dallas-Fort Worth and Nashville. They have avoided the TWA hub. That is the source of the competition in Missouri.

The two TransWorld Express carriers that operate into Lambert Field, Air Midwest and what used to be Resort Air and is now called TransStates, do control that market pretty well, and that is because of their connection with TransWorld. That is the advantage of code-sharing the passenger gets. When he gets on that airplane in Springfield, Missouri, he gets a through ticket all the way to wherever he is going. His bag goes all the way. He gets a con-

venient connection, and in most cases the amount of the fare that he pays for that short trip from, say, Springfield to St. Louis is much less than he would have paid had the two carriers been totally independent.

The other subject you mentioned was whether or not it was a deceptive practice for the consumer, and I have to disagree with that. I think that there are many steps in place to make sure that the consumer knows that he is operating on a different company. One is that the companies are not called TWA. They are called Trans-World Express.

The travel agents or the reservations agents are required to tell a person when he buys a ticket that he is changing to a different company.

There are signs that are required right on the side of the airplane that say this airplane is being operated by TransStates or Air Midwest.

Senator DANFORTH. Further presenting my chin to your fist, why does code-sharing provide more convenient service that could not be provided by interline agreements?

Mr. FREDERICKSEN. Well, I will tell you how a code-sharing arrangement works. There is a partnership, but that is a loose term. Basically, the regional airline changes its schedules to match the schedules of the big airline, and the computer reservations systems are used to do that. The big airline charges the small airline for every passenger that it gets on its ticket system. That arrangement, though, works real well for the passenger because you are able to set up a very symbiotic system that operates almost as though the major airline owns that small airline, and you get connections that are half an hour rather than what would otherwise be a random system.

Senator DANFORTH. It is difficult for me to see how an anticompetitive practice could help the traveling public, and it is further difficult for me to see how anything that you have mentioned as a convenient service could not be provided by contract without code-sharing.

Mr. FREDERICKSEN. You mean without using the name?

Senator DANFORTH. That is my understanding of what code-sharing means, simply that on the computer screen the letters appear which are the same as the letters of the major airline.

Mr. FREDERICKSEN. There is more to it than that. To enter into a code-sharing arrangement is a very expensive and involved operation. The major airlines generally demand that the customer get a level of service that they feel is equivalent to their operations. The ticket counters are changed. The uniforms of the people at work are changed.

Senator DANFORTH. Well, believe me, nobody who flies from here to Columbia once they got at the airport would conceivably confuse a TWA plane with a Resort Air, or whatever it is now called, plane.

Mr. FREDERICKSEN. I do not think that is so easy, Senator, because, as I mentioned, 15 of my member airlines are fully owned by the majors. If you get on an American Eagle flight in most of the country, you are getting on an American Airlines flight. If you get on a Pan Am Express, you are getting on a Pan Am——

Senator McCAIN. That is not the same thing. That is not code-sharing.

Mr. FREDERICKSEN. If you do not consider it code-sharing—and it is not totally clear from the bill—what you are doing is telling every major airline they better get out there and buy those regionals right now.

Senator DANFORTH. Let me tell you my understanding about code-sharing. My understanding of code-sharing is that when you look at the screen, the same letters appear for the major airline as for the commuter airline, thereby creating the impression that it is a single airline that is flying you all the way.

Mr. FREDERICKSEN. That is true; there is the single letter.

Senator DANFORTH. The baggage handling and whatever other arrangements can be handled by contract separate and apart from the code-sharing; and that, therefore, the code-sharing which presents one airline as being another airline is really a deceptive practice in that it is anticompetitive.

Mr. FREDERICKSEN. Well, as I said, I do not think it is anticompetitive other than the fact that it offers the passenger a better product. When you look at a computer screen, it says TW, but if it is a TW commuter it says TW with a star next to it. It is the same as when you look in the official airline guide. There is always a star next to it to tell you that that is not the same airline. A sophisticated or even a nonsophisticated traveler knows that.

I think the committee should be very careful. This feed traffic, the feed from the regional airlines, is very important to the majors. I have heard major airline presidents say that represents their profit margin.

Senator McCAIN. May I ask just one question, Senator Danforth? How can a new commuter airline start service from a small community when faced with competition from a competitor that shares a code with a major airline?

Mr. FREDERICKSEN. That is a tough question. The answer is it is very hard to do that. You have to start service in a community that the major airlines are not interested in, and that is the bottom line.

Senator DANFORTH. I want to just say to you that I have never had an idea in my life which has not been open to question if somebody can present me with a strong argument against it. I met last Friday in Joplin with officials for their community and people who are very interested in their airport. They expressed great concern about the code-sharing provisions of this bill. So naturally, if anybody presents concern I am going to look at it again.

You have presented concern. It does not strike me, just off the top of my head, that what I understood this bill to be doing would in any way disadvantage the people who are using the commuter airlines because I viewed it simply as an antideceptive practice provision.

Mr. FREDERICKSEN. I really think this part of the bill, on this part which I am talking about, the code-sharing part, will definitely drive a concentration of this airline industry, because those major airlines who do not already own their feeder networks will be forced to do so if this bill is enacted.

Senator DANFORTH. Okay. Thank you very much.

Senator FORD. Thank you, Senator Danforth.

I do not understand. I am just as happy as I can be that I have American Eagle in my hometown and Northwest commuter. That is the only connection we have. I do not worry too much about code-sharing at all. Maybe it is competitive out there, but boy, when that is all you have, you like it.

When I get my little sheet from the airline ticket office or from the travel agency, it's always Delta, ComAir, American Eagle; it is all right there. If I can read, I understand that I am going from one airline to another. I have no problem, and I find that pretty standard throughout all of the different agencies that provide tickets. I have never had them tell me you are going on that big bird and you are going to land in Owensboro and we have a 3,000 foot runway there. It does not work that way, Jack.

Let me finish up with a couple of questions here.

Mr. Johnson, I have always had a strong feeling about you fellows. It seems like you are in Catch 22. If airlines are in trouble they fuss at you; if the public is in trouble they fuss at you; and the city fathers fuss at you if the airport is not properly operated, and if you do not fill out the right kind of forms so you can get some money to pour some more concrete. Then everybody wants to get on your airport for nothing. We have a little problem with that, so we are going to get into some of that later on, I think the week after next.

What role do you believe air carriers should play in airport expansion and development?

Mr. JOHNSON. I think as a major user of that development, air carriers should be involved from the beginning in user consultation which is essentially required under the AIP program today. I think that consultation has provided good guidance to airports as it relates to the needs of the airlines and our attempt to match those needs with their expressions.

Senator FORD. Airlines never make a decision to use an airport operated by your membership unless there is something there that will benefit them and their expansion is a possible improvement in passengers. All those things are taken into consideration before an airline decides to come in or you have the things available.

So it is a mutual understanding between you and the airline, is it not?

Mr. JOHNSON. It is a mutual understanding. At some airports, however, there are airlines that would like to come in and cannot.

Senator FORD. I understand. Well, your testimony indicates that the majority-in-interest clauses limit competition. What action should we take to address those clauses?

Mr. JOHNSON. I think that the majority-in-interest clause was created in a regulated society, at which time the incumbents were always going to be at a given airport. They were, therefore, designed to protect the carriers from airports overbuilding. I think, however, with the deregulated system in which we now operate, airports would like in some instances to build additional facilities to meet demands that they see for their local community. In some instances those have been blocked.

I think perhaps in the past they have been blocked to a limited extent because carriers and airports have tried to work out realis-

tic solutions to the demand that they felt carriers would support. As a result, airport operators have not tried to expand airports to the point where we would have additional capacity today. I think the impact of majority-in-interest clauses probably will be greater in the future as we try to further expand airports to accommodate new entrants and also those who are seeking to expand.

Senator FORD. The airport improvement trust fund is limited to concrete and aprons and land and so forth. I am not sure about slots, but what about gates? I heard Lambert Field make the statement that they might be able to expand a few more gates but that is the end of it.

Would you have any interest or would there be any interest in using that trust fund to help you with gates, provided a new entrant was going to be involved?

Mr. JOHNSON. I think it would be beneficial if gates could be funded through the trust fund. At the present time there is really a prohibition against using those funds for——

Senator FORD. I understand, but there would have to be some kind of guarantee, I think, that you were improving competition.

Mr. JOHNSON. I also think that airports that use those funds or alternate sources should not charge incumbents for new gates that are not used. I think airports should assume that responsibility until such time as the tenant is found; or if they believe that a tenant will come immediately, it is probably a moot point.

Senator FORD. Let us talk about Midwest Express here a little bit and see how we do.

Your testimony refers to the slot withdrawal lottery conducted by FAA in 1986, I believe.

Did Midwest Express sell any of the slots they acquired through the lottery?

Mr. HOEKSEMA. Yes, sir. We received four slots at Washington National Airport in 1985 through the scheduling committee. They were Air One slots. Air One went bankrupt. We got those through the luck of the draw.

In the SFAR-48 withdrawal lottery in 1986, we got four LaGuardia slots and two additional Washington National slots.

Senator FORD. So that is six and four?

Mr. HOEKSEMA. Yes, sir. The Washington National slots that we got in the 1986 lottery were significantly better times to meet our schedule than the slots that we had gotten in 1985. A buy-sell was in effect.

Senator FORD. Are those Washington National slots?

Mr. HOEKSEMA. Yes, sir. Buy-sell was in effect at the time. I was very happy to see buy-sell come. I thought it was a system that was going to work very well. Not having additional aircraft at the time, we sold two of the slots and we kept the slots that had the better times for our schedule and for our customers in Wisconsin thinking that when we purchased additional aircraft we could then, through the buy-sell mechanism, buy additional slots. Unfortunately, that has not been the case in practice under buy-sell.

Senator FORD. So you did sell two slots expecting to buy some from someone else and there were none out there to buy?

Mr. HOEKSEMA. That is correct.

Senator FORD. Is it fair to ask you what you received for it? Is that part of the public record?

Mr. HOEKSEMA. I do not believe that that is public record anywhere.

Senator FORD. Okay. It did not hurt you any, though, when you sold them, did it?

Mr. HOEKSEMA. It did not hurt us.

Senator FORD. Would allowing commuter carriers to sell their slots only to new entrants or to limited incumbents help the solution to the problem that Midwest Express and others face?

Mr. HOEKSEMA. I am sorry?

Senator FORD. Would allowing commuter carriers to sell their slots only to new entrants or to limited incumbents——

Mr. HOEKSEMA. I guess that is difficult to answer. I thought buy-sell initially was going to work, and it has not. I do not know if commuter airlines have slots that would be available to sell. If there were slots out there available to sell at reasonable prices, we would be very interested. It is just difficult for me to answer.

Senator FORD. Let us talk about CRSs for just a minute.

Have you been offered an opportunity to participate in ownership of any CRS system?

Mr. HOEKSEMA. No, sir.

Senator FORD. None whatsoever?

Mr. HOEKSEMA. I do not believe so.

Senator FORD. Have you tried to buy in?

Mr. HOEKSEMA. No, sir.

Senator FORD. You have made no effort, but no one has come knocking at your door trying to sell you anything, either?

Mr. HOEKSEMA. That is correct.

Senator FORD. DOT has made two different decisions on CRSs, and we have to go from there. Other testimony about airport access indicates that the majority-in-interest clauses inhibit entry into the airport.

Has Midwest Express encountered such difficulty?

Mr. HOEKSEMA. At Milwaukee where we are a signatory carrier, when we wanted to expand, the system there delayed that for approximately a year because all the signatory carriers had to vote for that. We were ready to expand before others were. We have not run into those obstacles at many of the other airports we serve except to say to the extent that it has inhibited expansion at those airports it would have made the acquisition of gates more difficult for us.

Senator FORD. I believe I have no other questions. It would just be a repetition of what some of my colleagues have asked.

You all have been mighty patient. They have called me Old Iron Bucket, so I could just stay here a long time. We like to stay here a long time and sweat and fume and fuss. It is part of the game.

I do appreciate your effort, and there is one thing I want to promise you. We are going to try to work it out. It seems like it is very difficult at times to get anybody to listen, but we will do our best.

I have an awfully hard time with PFC. It seems like a kinder, gentler world if you want it you pay for it, and you can do it at home. When we find the new transportation policy in this country,

that is to increase taxes or increase the fee or whatever you want to call it; a rose by any other name. Then we put an additional charge on so you can operate your airport. We have a $7 billion surplus, but I am afraid if we increase the income that we will wind up with a $11 billion surplus. Your people will be fussing and fuming about your tickets being raised, and we are sitting around here with smoke and mirrors trying to tell you how great it is and you are just not handling your operation properly.

So if there is any increase, I promise you it is going to be in and out. If we collect it, it is going to come in and go out. We might spend it wrong, but it is not going to sit around here and jingle in somebody's pocket.

I hope you all will lend me your support. Those of us who are trying to find a way to make airport operators have an easier life and those who are trying to get into the competition and make it a little better and those who are in regions who want to expand. We ought to let the airports grow if we can, but it ought to be a planned procedure.

I think you have a little bit of a problem in Lambert that other communities have. You are almost downtown now, are you not?

General BENNETT. Yes, sir.

Senator FORD. You ought to come to Louisville. Have you been to Louisville lately?

General BENNETT. Yes, sir.

Senator FORD. When you take 1,600 homes and 17 churches and a few things like that, I am not sure you want to be a local mayor or a county judge or an airport manager. It gets to be pretty tough. We are going to make it. We are going to do it one way or the other, and that is what I think we are going to have to do: bite the bullet and grab at it.

So you all continue with not too much tenacity but just enough. Bear with us, and we are going to work for you.

Thank you all for your testimony, and we look forward to working with you and seeing you again.

[Whereupon, at 5:47 p.m. the hearing was adjourned.]

[The following information was subsequently received for the record:]

STATEMENT OF HON. NANCY LANDON KASSEBAUM, U.S. SENATOR FROM KANSAS

Mr. Chairman, I appreciate the opportunity to express my views regarding S. 1741, the Airline Competition Enhancement Act of 1989. I would like to commend Senators Danforth and McCain for their efforts on the important issue of competition in the airline industry. The problem this bill seeks to address is certainly one that requires our attention: Fewer airlines have led to greater concentration at hub airports and that concentration has resulted in higher fares for the travelling public. Although I may disagree with how S. 1741 attempts to resolve this problem, I support its basic goals.

Specifically, I believe the provisions of the bill concerning computer reservation systems have some merit. In addition, improving the means by which claims of anticompetitive or deceptive practices may be heard is worthy of further consideration. I also believe there is an urgent need to find a solution to the current slot-allocation problem at high-density airports. However, I do have concerns with the provision of the bill that calls for the auction of slots. I believe there are alternatives, such as allowing commuter slots to be used for jet service, that may be worth further examination.

In any case, the current shortage of slots and operating capacity at high-density airports are indeed obstacles to new entrants. Efforts to reduce such barriers to competition should be encouraged. Another such barrier of particular concern to me is language in the International Air Transportation Competition Act of 1979, pertaining to air carrier service at Dallas Love Field. I have introduced a bill, S. 1333, that would repeal this language and remove this restriction on competition.

Ten years ago, a section was included in the International Air Transportation Competition Act to prohibit commercial air carriers from providing service between Dallas Love Field and points located outside of Texas or its four surrounding states. This effectively limits travel into and out of this airfield to only destinations in Texas, Louisiana, Oklahoma, Arkansas, and New Mexico.

Air carriers originating from all other states, must fly into the Dallas-Fort Worth airport in order to have access to the highly traveled Dallas area. This restriction applies as well to any carrier that provides connecting service within one of the four contiguous states to an aircraft that originated in any other state. Two separate, one-way tickets are required for such connecting flights if they want to land at Love Field. Clearly, the restrictions have made it prohibitive to land at this airfield.

Upon examination, it is evident that this has led to higher air fares for some segments of the United States and lower air fares for others, regardless of the distance traveled and the populations served. Fare discrepancies exist in many of the markets where major carriers serve Dallas, but where Southwest Airlines does not. Southwest is currently the only commercial air carrier providing jet service to Love Field. This has left states just beyond the

borders of the Texas-contiguous states, such as Colorado, Missouri, Tennessee, Mississippi, and Kansas, subject to higher fares to Dallas than their neighbors even though the distance traveled is less. Such unfairness should not be allowed to continue.

Since Southwest cannot provide direct service to any point beyond the four contiguous states, other carriers have little reason to reduce their fares to other "outside" destinations. The fact that fares to Dallas are so low for those points which Southwest serves speaks to the need for removing the 10-year-old restriction on Love Field.

To allow this situation to continue would be to condone anticompetitive law and to encourage discrimination against many for the benefit of a few. Like Senators Danforth and McCain, I believe it is essential to encourage competition within the transportation community in order to protect the interests of the travelling public.

Finally, I would like to mention that in the wake of deregulation, we have witnessed a number of bankruptcies within the airline industry. Airline ticket holders have been left stranded when bankruptcy is declared. For this reason, I have introduced, with Senator Danforth, S. 1858, the Airline Bankruptcy Passenger Protection Act of 1989.

Under this legislation, the airline industry would be required to develop a plan which protects airline ticket holders when an airline declares bankruptcy. If a satisfactory plan is not submitted by a specified deadline, the bill requires the Secretary of Transportation to issue regulations requiring all covered air carriers to provide air transportation for such ticket holders. This legislation will help restore the public confidence necessary to maintain the integrity and reliability of our public air transportation system.

TESTIMONY OF THE
AMERICAN SOCIETY OF TRAVEL AGENTS, INC

INTRODUCTION

The American Society of Travel Agents, Inc. ("ASTA") appreciates the opportunity to present testimony before the Committee in its consideration of S. 1741, the Airline Competition Enhancement Act of 1989.

ASTA is the world's largest trade association of professional travel agents and has a vital interest in many of the issues raised by this legislation. ASTA makes regular input to the Department of Transportation and before the Congress whenever the opportunity arises. By virtue of the breadth of our organization, which has more than 11,000 agent members engaged in all phases of air transportation distribution, we are well aware of the issues and are competent to address them on behalf of our industry.

ASTA is opposed to the enactment of S. 1741 in several respects. While the legislation is well-meaning in purpose, we do not believe it is a practical approach to eliminating the barriers to effective competition that have arisen in our industry.

I. **DIVESTITURE OF COMPUTER RESERVATIONS SYSTEMS.**

On the issue of computer reservations systems, for example, the bill contains few words, but they are potent words in that they would force the divestiture of computer reservations systems by the airlines in less than one year. ASTA has been very aggressive in its complaints to the government about the abuses in the CRS market that we have perceived both before and after the Civil Aeronautics

Board adopted its CRS regulations in late 1984. We have filed two petitions for rulemaking with the Department of Transportation on these issues. We might, for that reason, seem to be a logical candidate to support the most draconian of solutions to the CRS competition problem.

As we have told the Department of Transportation, the evidence that the major vendors possess market power, and therefore have a competitive advantage, is so well documented in the Department of Transportation's 1988 CRS Study that it seems no longer genuinely debatable. The large vendors have an enormous advantage when their dominance of an air transportation market is combined with their dominance of CRS placements in the local travel agency community.

Using onerous contract provisions that include huge liquidated damages, rollovers, minimum use and long terms, the dominant vendors lock in the travel agency community and assure the vendors' position in competition for passengers as against other airlines seeking to enter the market. Because of the long duration of these CRS contracts, these effects linger even after the vendor's affiliated airline has reduced its schedules or departed the market. The vendor continues to extract unreasonable booking fees from the replacement carrier for every segment booked by local travel agents. The 1988 DoT CRS Study establishes beyond doubt that these booking fees are extraordinary and not justified by any risk associated with the vendors' investment in CRS facilities.

The federal courts in New York and elsewhere, applying state contract law, have upheld the enforceability of liquidated damage

clauses in CRS contracts. The result is that many travel agents will suffer huge, perhaps terminal, financial losses. Other agents now have the message: when you sign a CRS contract containing liquidated damages, you are stuck. If the carrier practices "rollover" of the contract term when new equipment is added, the agent, in order to grow, is essentially locked in permanently.

ASTA's rulemaking petitions would, if adopted, prohibit most of the onerous contract provisions that lock in travel agents regardless of changing market conditions. We do not believe that state contracts laws governing liquidated damages should be allowed to determine the policy in an area that so vitally affects interstate commerce and which is so fraught with other practices and conditions that restrict competition.

We have urged DoT to, among other things, reduce the maximum permissible term of CRS contracts to three years from the present five year maximum. Combined with an effective prohibition of rollover practices, this change would accomplish the most in freeing agents from the domination of the large vendors.

A three-year contract limit would force the vendors to compete more often for the CRS business of agents and would make it easier for agents to use multiple CRS systems. This, in turn, will help the public by making available alternative information sources through the same agent. It would help airlines seeking to enter a new market by reducing the number of cases where the dominant CRS is that of the major competing airline or that of an airline that has actually vacated the market.

ASTA believes that its proposals, combined with others contained in our rulemaking petitions with DoT will resolve the most serious abuses of CRS market power. We further believe that the Department of Transportation, through its regulations, is the most appropriate vehicle for making these changes in the behavior of the vendors. The review of the CRS regulations that is required by DoT's existing regulations is now underway, and we are expecting a notice of proposed rulemaking to issue shortly.

Accordingly, ASTA does not believe that the divestiture remedy, as proposed by S. 1741, is the appropriate solution. While the legislation seems simple and direct enough on its face, the complexities of forced divestiture are such that the actual divestiture simply could not be implemented in time to restore competition to the market when it counts most. If divestiture were ordered now, the Department of Transportation rulemaking procedure might well be delayed or halted. While the legal battle over the divestiture legislation raged on, the industry would continue to suffer under the current CRS rules, which have failed to achieve their goal of a fully competitive marketplace.

The better prospect for near-term relief from CRS market power thus lies with the Department of Transportation's rulemaking power.

II. REGULATION BY THE FEDERAL TRADE COMMISSION.

ASTA is likewise opposed to the elimination of the barrier to industry regulation by the Federal Trade Commission. The government often declines to intervene in serious problems arising

in the industry on the grounds that regulation is to be avoided and marketplace solutions are to be preferred in almost all cases. It would be perverse if the government were now to impose double regulation on the industry. The present jurisdiction of the Department of Justice and the Department of Transportation seem clearly sufficient to address any problems that may arise. If the Department of Transportation is perceived as lacking the will to use its authority, that problem should be addressed separately, and not by adding to the jurisdiction of another federal agency.

III. **PASSENGER FACILITY CHARGES.**

While ASTA has long been a vigorous and vocal supporter of the expansion of the airport and airway system, we are adamantly opposed to any plan that leaves the future development of that system dependent upon local taxes called "passenger facility charges". This legislation contains no limitations on such charges, other than the necessity to obtain the advance approval of the Department of Transportation. There is no requirement, nor could there realistically be a requirement, for uniformity in concept or amount as regards these "charges". The prospect therefore exists that, regardless of the good intentions of the Department of Transportation, a confusing regime of variable head taxes will be imposed by airports around the country. The cost of administering the collection and payment of these taxes would presumably fall upon the airline and travel agency industries.

These costs will not be recoverable. The effect is similar to an additional direct tax on the industry.

ASTA has contended for years that the existing airport trust fund should be used for necessary improvements to increase aviation safety and airport capacity. That fund, collected through the current eight percent domestic ticket tax, has amassed over seven billion dollars. It makes no sense to impose additional taxes on the travelling public when most of those that have already been collected are not being used for their intended purposes, such as enlarged airports, additional air traffic control programs and updated passenger facilities.

We are also concerned that the effect of the "passenger facility charge" program, as outlined in this legislation, will be to embroil the Department of Transportation in lengthy and complicated proceedings, requiring it to evaluate airport financing programs from around the country. While these proceedings, and possible court appeals from them, drag on, the much needed expenditure of funds to enhance the airport and airway system may be retarded even more than it is now.

** END **

STATEMENT OF RICHARD DICKIESON, PRESIDENT, TRAVEL AVENUE

As president of the nation's first discount travel agency, Travel Avenue, I feel very qualified to address the subject of airline competition. Some of the most effective and harmful methods of stifling competition are the practices airlines use to influence the sales travel agents make to the public. Having had to compete in a marketplace where the items listed below are common occurrences I know how they hamper fair and unfettered competition in the airline marketplace. Please keep in mind that all of the anti-competitive behavior discussed in this paper would be prohibited if Congress would make it clear, by law, that the Robinson-Pattman Act applies to airlines.

The most harmful detriment to greater airline competition is that currently airlines can treat competing travel agencies differently, with the basis of that treatment being nothing more than whim; or even worse, made on the basis of race or national origin. Such behavior, as you know, is illegal under Robinson-Pattman Act.

For example, lets say that there are two travel agencies that are exactly the same in all aspects, located across the street from each other. The only difference between the two companies is that one, which we will call Good Guy Travel, gives unbiased advice and the other, which we will call Biased Travel, steers an above average portion of its business to Airline "A." As the situation currently exists

Airline "A" can penalize Good Guy Travel in a number of ways all of which have the net result of keeping this unbiased travel agency small and eventually driving it out of business. Let's look at some of the ways this can be done.

1. Airline "A" can cut a favorable deal with Biased Travel on the Computer Reservation System that Biased Travel uses. Immediately Biased Travel has a cost advantage over Good Guy Travel in the cost of doing Business.
2. Airline"A" can pay Biased Travel a higher commission than Good Guy Travel even though they both may do the same amount of business with Airline "A."
3. Airline "A" can allow Biased Travel to book its customers in Airline "A's" higher priced seats while charging them the cost of lower priced seats. This could take the form of upgrading full fare coach seats to first class or charging super saver fares to customers when they are booked in full fare seats.
4. Airline "A" can give Biased Travel free and reduced rate tickets for its employees while withholding them from Good Guy Travel. This helps Biased Travel in two ways. First, they can hire better employees because of a more attractive benefits package and secondly, they can fly their sales employees to out of town sales calls for business much more cheaply than their competitor.

5. Airline "A" can give Biased Travel free tickets for Biased Travel to distribute to its corporate accounts, either as a reward for choosing Biased Travel or as an incentive to a prospective account for choosing Biased Travel. Good Guy Travel gets nothing.
6. Airline "A" can help Biased Travel out if it has a problem. Some examples of this would be in clearing an important customer of Biased Travel onto a full flight or by forgiving a bill for a ticket issued at the wrong fare. Airline "A" can withhold the favored treatment from Good Guy Travel.
7. Airline "A" can refer business to Biased Travel. For example, let's say that a company contacts Airline "A" directly about a special corporate rate for the company's employees. Airline "A" can say that it would be glad to give the corporation a special deal as long as the corporation shifts its business to Biased Travel. Good Guy Travel, in the best situation, does not get the referral, and in the worst situation loses an account that it already had.
8. Airline "A" can sell Biased Travel an automated accounting system at a much lower price than it sells the same system to Good Guy Travel. In some instances Airline "A" may <u>give</u> Biased Travel the accounting system for free.

9. Airline "A" can give Biased Travel money for advertising and promotion while not including Good Guy Travel in on their co-op advertising program.
10. Airline "A" can simply cut off Good Guy Travel by refusing to allow them to sell tickets for Airline "A." Not only does this deprive Good Guy Travel of a significant portion of its revenue but puts them in the position of being the only travel agency that can't sell tickets on all airlines. This also allow Biased Travel to tell potential customers that Good Guy Travel is, of course, biased because it can't sell seats on all airlines.

As you can see all of these "favors" give Biased Travel a huge advantage over Good Guy Travel in both the price it pays for airline tickets and in the amount of money it takes to operate its business. Some of the advantages make their way to Biased Travel's customers in the form of rebates which only serves to increase the number of companies and/or individuals that choose Biased Travel over Good Guy Travel.

The greater Airline "A's" market share is in the community served by Biased Travel and Good Guy Travel the more effective this process is. It does not have to be only the airline with a dominant market share that plays these games. Any airline can do it. However, the greater the airlines market share the greater its effectiveness in playing the

game. Indeed, this is the form competition takes in the market today.

Over a period of time what we end up with is a huge Biased Travel that owes its allegiance and profitability to Airline "A" and a bankrupt Good Guy Travel whose only crime was to offer unbiased advice. Airline "A" has improved its position in the market served by Biased Travel by getting rid of a travel agency that treated it the same as other airlines while retained a travel agency that pushes sales on Airline "A." As Airline "A" repeats this situation over and over again airlines not practicing this type of anti-competitive behavior get pushed out of the market. Airline and travel agency competition is lessened and prices increase.

The problem with this type of airline competition is that the surviving travel agencies are not chosen by market processes, which would have those who give the best service and are most efficient surviving. Instead surviving travel agencies are selected by under the table deals that both the travel agencies and the airlines pretend do not exist.

An example of the asttempt by airlines to make the public think travel agencies are unbiased are the airline ads which always say "see YOUR Travel Agent." They hope that the consumer will believe that the travel agency that the consumers visit is working for the consumer, not for the airline that places the ad.

The surviving travel agencies are not those that serve the consumer best, but those that serve a particular airline (or airlines) best. By applying the law of Robinson-Pattman to the airline industry these abuses can be stopped and consumers can be served by a distribution system that responds to fair market forces, not the market power that one airline can apply to its list of favored travel agencies.

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